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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 49

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

R. DOUGLAS STUART

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 19, 1942

CERTIORARI GRANTED APRIL 27, 1942

In the

United States Circuit Court of Appeals

For the Seventh Circuit

No. 7696

R. DOUGLAS STUART,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Review of Decision of the United States Board of Tax Appeals.

INDEX.

STATEMENT OF EVIDENCE.

PETITIONER'S WITNESSES.

1 R. Douglas Stuart, *Petitioner*, vs. Commissioner of Internal Revenue, *Respondent*. } Docket No. 97501.

Appearances:

For Taxpayer: Herbert Pope, Esq., Benj. M. Price, Esq., Preston B. Kavanagh, Esq.

For Comm'r: D. A. Taylor, Esq.

DOCKET ENTRIES.

1939

Mar. 14—Petition received and filed. Taxpayer notified. (Fee paid).

Mar. 14—Copy of petition served on General Counsel.

Mar. 14—Request for circuit hearing in Chicago, Ill., filed by taxpayer. 3/14/39 copy served.

May 2—Answer filed by General Counsel.

May 8—Copy of answer served on taxpayer, Chicago, Ill., Calendar.

1940

Mar. 22—Hearing set May 6, 1940, Chicago, Ill.

May 6—Hearing had before Miss Harron on merits. Submitted. Respondent moves to amend answer—granted. Amended Answer to be filed. Stipulation of facts filed. Amendment to answer filed 5/8/40. Briefs due 6/20/40; Replies 7/5/40.

May 16—Transcript of hearing of May 6, 1940, filed.

June 19—Brief filed by taxpayer.

June 20—Brief filed by General Counsel.

July 5—Reply brief filed by taxpayer.

Nov. 29—Finding of fact and opinion rendered, Harron, Div. 13. Decision will be entered under Rule 50.

Dec. 17—Computation of deficiency filed by General Counsel.

Dec. 27—Hearing set Jan. 15, 1941 on settlement.

1941

Jan. 9—Consent to settlement filed by taxpayer.

Jan. 10—Decision entered, Marion J. Harron, Div. 13.

Jan. 14—Order vacating decision of 1/10/40 entered.

Jan. 14—Decision entered, Marion J. Harron, Div. 13.
Apr. 1—Supersedeas bond in the amount of $66,079.00, approved and ordered filed.
Apr. 3—Petition for review and statement of points by United States Circuit Court of Appeals, Seventh Circuit, filed by taxpayer.
Apr. 5—Proof of service of filing petition for review and statement of points filed.
May 6—Motion for extension of 30 days within which to settlement the statement of evidence and transmit the record filed by taxpayer.
May 6—Order enlarging the time to June 12, 1941 for preparation of the evidence and transmission and delivery of record, entered.
2 May 29—Agreed statement of evidence filed.
May 29—Agreed praecipe for record filed.

Filed Mar. 14, 1939. 3 UNITED STATES BOARD OF TAX APPEALS.

R. Douglas Stuart, *Petitioner*,
vs.
Commissioner of Internal Revenue, *Respondent*.
} Docket No. 97501.

PETITION.

Filed March 14, 1939.

The above named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:R:D:1:AHS-90D) dated December 29, 1938, and as a basis of his proceeding alleges as follows:

1. The petitioner is a resident of Lake Forest, Illinois, and his residence address is 528 Mayflower Avenue, Lake Forest, Illinois. He filed his income tax returns for the years here involved with the Collector of Internal Revenue for the First District of Illinois.

2. The notice of deficiency, a copy of which is attached hereto and marked "Exhibit A", was mailed to the petitioner on December 29, 1938.

3. The taxes in controversy are income taxes for the years 1934 and 1935. The deficiencies claimed by the
4 Commissioner are $19,323.70 for the year 1934 and $13,715.38 for the year 1935, and the entire amount of both deficiencies is in dispute.

4. The determination of the deficiencies set forth in said notice is based upon the following error:

The determination by the Commissioner that the income of four trusts created by the petitioner for the benefit of his children was taxable to the petitioner under the provisions of Section 166 of the Revenue Act of 1934.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) On March 25, 1932, the petitioner, by four separate trust agreements, created four trusts for the benefit of his four children respectively. The trustees of each trust are the petitioner, his wife and his brother. Each trust agreement provides an income for the benefit of the child for whom the trust was created and for distribution of the principal to said child in instalments at certain ages designated in the trust agreement, with contingent gifts to other persons if the child should die before receiving the entire principal.

(b) There was and is no provision in said trusts
5 under which the petitioner could ever receive any principal or income thereof. The petitioner did not retain the power to revest in himself title to any part of the principal of the trusts.

(c) The petitioner wanted to have his children protected and, accordingly, provided in paragraph Ninth of each of the trust agreements that his wife and his brother, or the survivor, should have the right to amend the trust by changing the beneficiary or by changing the time when income or principal should be payable, or in other respects, but there was no intention and no provision that they could modify the trust so as to revest in the petitioner title to any part of the principal of the trust. It was in fact specifically provided in paragraph Eighth of each trust that if the petitioner desired to exercise his right under the provisions of said paragraph to withdraw any property from the trust he could do so only upon first transferring to the trustees other property satisfactory to them, of a market value at least equal to that of the property
6 withdrawn. It was the intent of the trust agreement that no portion of principal could be revested in the peti-

tioner by anyone without such substitution of other property satisfactory to the trustees and of at least equal
6 value to the property withdrawn.

(d) The petitioner's wife and brother, who had power to modify the trust in the manner above stated, were also trustees and could not legally as trustees have revested any principal of the trusts in the petitioner except in exchange for property of equal value which was satisfactory to them. To remove any possible doubt as to this, and after a question had been raised as to the effect of provisions contained in Section 166 of the Revenue Act of 1934 which had not been contained in the corresponding section of the Revenue Act of 1928 in force when said trusts were created, the trust agreements were amended on August 3, 1935, by striking out said provisions of paragraphs Eighth and Ninth hereinabove described.

(e) In the audit of the petitioner's income tax returns for the years here in question the Commissioner included in petitioner's gross income the entire net income of said trusts for the year 1934 and for the period from January 1, 1935, to August 3, 1935, on the ground that such income was taxable to the petitioner under Section 166 of the Revenue Act of 1934, because of the alleged power in his wife and brother to revest the principal of the trusts in him.

(f) The petitioner avers that said trusts do not
7 come within the provisions of Section 166 of the Revenue Act of 1934 and that the income of said trusts is not taxable to him under said statutory provisions.

Wherefore, your petitioner prays that the Board may hear this proceeding and that it disapprove and disallow the deficiencies determined by the Commissioner.

Herbert Pope,
Benjamin M. Price,
Preston B. Kavanagh,
Counsel for Petitioner,
707 Munsey Building,
Washington, D. C.

8 State of Illinois, } ss.
County of Cook. }

R. Douglas Stuart, being duly sworn, says that he is the petitioner above named; that he has read the foregoing petition and is familiar with the statements contained therein and that the facts stated therein are true.

R. Douglas Stuart.

Subscribed and sworn to before me this 3rd day of March, 1939.

W. McKenzie Mothersill,
Notary Public.

(Notarial Seal)

9 EXHIBIT A.

December 29, 1938.

IT:R:D:1
AHS-90D

Mr. R. Douglas Stuart,
528 Mayflower Avenue,
Lake Forest, Illinois.

Sir:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1934 and 1935, discloses a deficiency of $33,039.08 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C1:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest

period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

Guy T. Helvering,
Commissioner.

By (Signed) John R. Kirk,
Deputy Commissioner.

Enclosures:

Statement AHS/AMEN-2
Form of waiver

10 Statement.

IT:R:D:1
AHS-90D

Mr. R. Douglas Stuart
528 Mayflower Avenue
Lake Forest, Illinois

Tax Liability for Taxable Years Ended December 31, 1934 and 1935

Income Tax

Year	Liability	Assessed	Deficiency
1934	$ 54,668.43	$ 35,344.73	$ 19,323.70
1935	81,920.32	68,204.94	13,715.38
Totals	$136,588 75	$103,549.67	$ 33,039.08

In making this determination of your income tax liability, careful consideration has been given to the internal revenue agent's report dated January 19, 1937; to your protest dated March 10, 1937, and to the statements made at a conference held in this office.

A copy of this communication has been transmitted to your representative, Mr. P. B. Kavanagh, 707 Munsey Building, Washington, D. C., in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

1934

Adjustment to Net Income

Net income as disclosed by return	$117,153.17
Unallowable deductions and additional income:	
Income from fiduciaries	37,162.91
Net income adjusted	$154,316.08

Explanation of Adjustment

On March 25, 1932, you created separate trusts for each of your four children, Robert Douglas Stewart, Jr., Harriet McClure Stuart, Anne Stuart, and Margaret Jane Stuart. You appointed your wife, Harriet McClure Stuart, and your brother, John Stuart, to act with you as trustees.

11 The Trustees have full power to sell, transfer, or assign any or all of the stocks, bonds, or securities, and to invest and reinvest the proceeds thereof. Each of the trust instruments has substantially the same provisions regarding the method of distribution to the beneficiaries and the powers of the trustees. In each of the trusts paragraph 9 provides that during your life Harriet McClure Stuart (your wife) and John Stuart (your brother) or the survivor of them, shall have full power and authority by an instrument in writing signed and delivered by them or by the survivor of them to the trustees, to alter, change, or amend this indenture at any time and from time to time by changing the beneficiaries, or by changing the time when the trust fund or the income is to be distributed, or by changing the trustees, or in any other respect. Section 166 of the Revenue Act of 1934 specifies that:

"Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

* * * * * *

"(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor."

Neither your wife nor your brother has a substantial adverse interest in the disposition of the corpus of these trusts, hence this office is of the opinion that these trusts

are revocable trusts until August 3, 1935, when the trust agreements were amended by striking out the provisions of paragraph 9, and as such are taxable to you under the provisions of section 166 of the Revenue Act of 1934.

Computation of Tax

Net income adjusted		$154,316.08
Less:		
Personal exemption	$2,500.00	
Credit for dependents	1,333.34	3,833.34
Balance (surtax net income)		$150,482.74
12 Less:		
Dividends	$136,716.87	
Interest on Liberty bonds, etc.	318.75	
Earned income credit	1,400.00	138,435.62
Net income subject to normal tax		$ 12,047.12
Normal tax at 4% on $12,047.12		481.88
Surtax on $146,482.74 (amount in excess of $4,000.00)		54,255.85
Total tax		$ 54,737.73
Less:		
Income tax paid at source		69.30
Correct income tax liability		$ 54,668.43
Less:		
Income tax previously assessed, account #200280		35,344.73
Deficiency of income tax		$ 19,323.70

1935

Adjustments to Net Income

Net income as disclosed by return		$175,794.47
Unallowable deductions and additional income:		
(a) Ordinary interest increased	$ 388.33	
(b) Income from fiduciaries increased	25,831.15	26,219.48
Total		$202,013.95
13 Non taxable income and additional deductions:		
Interest on tax-free covenent bonds overstated		388.33
Net income adjusted		$201,625.62

Explanation of Adjustments

(a) Ordinary interest has been increased and tax-free interest has been decreased inasmuch as the following bonds do not carry the 2 percent tax-free clause.

Pinehurst, Inc.	$. 60.00
Benjamin Electric Company	12.00
Continental Securities Co.	250.00
General Baking Company	18.33
Indian Hill Country Club	18.00
Winter Club	30.00
Total	$388.33

(b) As fully explained, it is the opinion of this office that the four trusts created by you for your children are taxable to you until such time as the trusts were made irrevocable. This was done on August 3, 1935; hence the income of these trusts for the period from January 1, 1935 to August 3, 1935, is taxable to you, the grantor, under the provisions of section 166 of the Revenue Act of 1934.

Computation of Tax

Net income adjusted		$201,625.62
Less:		
Personal exemption and credit for dependents		3,700.00
Balance (surtax net income)		$197,925.62
14 Less:		
Dividends	$127,483.99	
Earned income credit	1,400.00	128,883.99
Net income subject to normal tax		$ 69,041.63
Normal tax at 4% on $69,041.63		2,761.67
Surtax on $193,925.62 (Amount in excess of $4,000.00)		79,400.58
Total tax		$ 82,162.25
Less:		
Income tax paid at source		241.93
Correct income tax liability		$ 81,920.32
Less:		
Income tax previous assessed, original, account #204510		68,204.94
Deficiency of income tax		$ 13,715.38

AHS/AMEM-2

Filed May 2, 1939. 15 UNITED STATES BOARD OF TAX APPEALS.

• • (Caption—97501) • •

ANSWER.

(Filed May 2, 1939.)

The Commissioner of Internal Revenue by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits, denies and alleges as follows:

1, 2, and 3. Admits the allegations contained in paragraphs 1, 2 and 3 of the petition herein.

4. Denies the allegations contained in paragraph 4 of the petition herein.

5. (a) Denies the allegations contained in subparagraph (a) of paragraph 5 of the petition herein, except it is admitted that on March 25, 1932, the petitioner by certain trust agreements created four trusts for the benefit of his four children, respecively.

(b), (c) and (d) Denies the material allegations of fact contained in subparagraphs (b), (c) and (d) of paragraph 5 of the petition herein.

(e) Denies the allegations contained in subparagraph (e) of paragraph 5 of the petition herein, except it is admitted that in the audit of the petitioner's income tax returns for the years here in question, the Commissioner included in the petitioner's gross income the entire net income of said trusts for the year 1934 and for the period from January 1, 1935, to August 3, 1935, on the ground that such income was taxable to the petitioner under Section 166 of the Revenue Act of 1934.

(f) Denies the allegations contained in subparagraph (f) of paragraph 5 of the petition herein.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

Wherefore, respondent prays that the Board redetermine the deficiency herein to be the amount determined by the Commissioner, viz.: $33,039.08.

(Signed) J. P. Wenchel,
J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
F. R. Shearer,
Division Counsel.
D. A. Taylor,
Special Attorney,
Bureau of Internal Revenue.

Filed May 8, 1940.

17 UNITED STATES BOARD OF TAX APPEALS.

• • (Caption—97501) • •

AMENDMENT TO ANSWER.

(Filed May 8, 1940.)

The Commissioner of Internal Revenue by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, pursuant to leave granted by the Board at the hearing of this case on May 6, 1940, to amend respondent's answer herein, for amendment to the respondent's answer herein alleges:

That the income of the trusts mentioned in the petition herein aggregating $37,162.91 for the calendar year 1934 and $25,831.15 for the period January 1, 1935, to August 2, 1935, included in the petitioner's gross income in the notice of deficiency involved herein under the provisions of Section 166 of the Revenue Act of 1934 is taxable also to the petitioner herein under Section 167 of the said Revenue Act for that the said income, in the discretion of persons not having a substantial adverse interest in the disposition of said income, may be held and accumulated for future distribution to the grantor; may be distributed to the grantor, and may be applied to the payment of premiums upon policies of insurance on the life of the grantor.

18 That after the creation of the aforesaid trusts the petitioner remained and during the years here involved he was substantially the owner of said property transferred in trust and retained the right to and did receive the economic benefits thereof by reason of which the income from the aforesaid trusts is taxable to the petitioner by virtue of Section 22 of the said Revenue Act of 1934.

Wherefore, respondent prays that the Board redetermine the deficiency herein to be the amount determined by the Commissioner, viz.: $33,039.08.

(Signed) J. P. Wenchel,
J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
F. R. Shearer,
Division Counsel.
D. A. Taylor,
Special Attorney,
Bureau of Internal Revenue.

19 UNITED STATES BOARD OF TAX APPEALS. Filed May 6, 1940.

* * * (Caption—97501) * * *

STIPULATION OF FACTS.

(Filed May 6, 1940.)

It is hereby stipulated by and between the parties to the above entitled cause through their counsel that the following statement of facts may be received in evidence as true, without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated.

1. The petitioner resides at 528 Mayflower Avenue, Lake Forest, Illinois. He filed income tax returns for 1934 and 1935, the years here involved, with the Collector of Internal Revenue for the First District of Illinois.

2. The notice of the deficiency here involved was mailed to the petitioner on December 29, 1938. A true and correct copy of the notice is attached to the petition heretofore filed in this proceeding. By reference said notice is
20 hereby made a part of this stipulation to the same effect as if it were incorporated herein.

3. On March 25, 1932, the petitioner executed an agreement, a true copy of which is attached hereto as Exhibit 1, creating a trust for the benefit of his son, Robert.

4. On the same date the petitioner executed another agreement creating a trust for the benefit of his daughter, Anne. The provisions of this agreement are identical with the provisions of the agreement mentioned in paragraph 3 hereof except for the designation of Anne as beneficiary instead of Robert.

5. On the same date the petitioner executed another agreement creating a trust for the benefit of his daughter, Margaret. The provisions of this agreement are identical with the provisions of the agreement mentioned in paragraph 3 hereof except for the designation of Margaret as beneficiary instead of Robert.

6. On the same date the petitioner executed another agreement creating a trust for the benefit of his daughter, Harriet. The provisions of this agreement are identical with the provisions of the agreement mentioned in paragraph 3 hereof except for the designation of Harriet as beneficiary instead of Robert.

7. The net income of the petitioner, as shown by his income tax returns and not including any income of the trusts, was $117,153.17 in 1934 and $175,794.47 in 1935.

21 8. The birth dates and ages (at nearest birthday) of said children are as follows:

Robert	April 26, 1916	24 years
Anne	January 11, 1920	20 years
Margaret	January 3, 1922	18 years
Harriet	February 3, 1928	12 years

9. On August 2, 1935, Harriet McClure Stuart, wife of the petitioner, and John Stuart, brother of the petitioner, executed an amendment of the agreement mentioned in paragraph 3 hereof. A true copy of said amendment is attached hereto as Exhibit 2. On the same date said Harriet McClure Stuart and John Stuart executed amendments of the agreements mentioned in paragraphs 4, 5 and 6 hereof, and said amendments contain the same provisions in regard to the respective agreements to which they refer as are contained in said Exhibit 2 in regard to the agreement to which it refers.

10. For the calendar years 1934 and 1935 the amounts of the net income of said trust as reported on the Fiduciary Returns and the amounts thereof that were distributed and the amounts that were retained by the trusts were as follows:

	1934	1935
Trust for Robert		
Net Income	$9,207.91	$9,859.20
Distributed to him	1,391.50	1,882.50
Retained by trust	7,816.41	7,976.70
Trust for Anne		
Net Income (all retained)	9,208.23	9,787.46
22 Trust for Margaret		
Net Income (all retained)	9,201.81	$9,782.17
Trust for Harriet		
Net Income (all retained)	9,226.20	9,788.20

11. The total net income of said trusts for 1934 was $37,162.91, and the respondent has determined that said net income is to be included in the gross income of the petitioner in computing his income tax for said year.

12. The total net income of said trusts for 1935 was $39,217.03, of which $25,831.15 was received by the trusts during the period from January 1, 1935 to August 2, 1935.

Respondent has determined that said amount of $25,831.15 of the net income of the trusts is to be included in the gross income of the petitioner in computing his income tax for 1935.

Herbert Pope,
Attorney for Petitioner.

time payable in respect of any shares of stocks, bonds, or other securities or property forming a part of the Trust Fund; to sell, transfer, and assign any or all of the stocks, bonds, securities or property held by the Trustees under this instrument, and to invest and reinvest the proceeds thereof and the net income derived therefrom, which shall not be distributed as hereinafter provided, in municipal or government bonds, stocks, real estate mortgages, or other income producing property or securities, real or personal, within or without the State of Illinois without being limited or restricted to investments as fixed by the statutes of the State of Illinois, and to make, execute and deliver all necessary and proper assignments, conveyances, deeds and other instruments; to exercise the voting power upon all shares of stock held by the Trustees hereunder, and to exercise every power, election and discretion, give every notice, make every demand, and do every act and thing in respect of any shares of stocks and bonds which they could or might do if they were absolute owners thereof; to unite with owners of similar property in carrying out any plan for the reorganization of any corporation or company, the securities of which form a portion of the Trust Fund; to exchange the securities of any corporation for others issued by the same or by any other corporation upon such

Indenture provided.

Second. The Trustees shall have power and authority to receive and collect all income from the Trust Fund, including dividends, interest and any and all sums at any terms as the Trustees shall deem proper; to assent to the consolidation or merger of such corporation; to pay such assessments, expenses and sums of money as they may deem expedient for the protection of the interest of the Trust Fund in stocks, bonds, or other

securities of any corporation or company; to employ such agents and attorneys as may be necessary. Any person dealing with the Trustees shall not be required to see to the application of any money or moneys paid to the Trustees.

Third. For the purpose of this Indenture, net income shall include interest, dividends and rents from stocks, bonds, and other securities and property constituting the Trust Fund after making any and all deductions therefrom in this Indenture provided for or required by law. Stock Dividends, liquidating dividends and proceeds from the sale of any part of the Trust Fund, including profits, if any, shall constitute principal.

Fourth. Until he shall arrive at the age of twenty-five years, the Trustees shall pay over to Robert Douglas Stuart, Jr., the son of the Donor, so much of the net income from the Trust Fund, or shall apply so much of said income for his education, support and maintenance, as to them shall seem advisable, and in such manner as to them shall seem best, and free from control of any guardian, the unexpended portion, if any, of such income to be added to the principal of the Trust Fund. When the said Robert Douglas Stuart, Jr. shall attain the age of twenty-five years, the Trustees shall pay over and deliver to him one-half of the Trust Fund; and they shall pay over to him in reasonable installments the income from the remaining one-half of the Trust Fund until he shall attain the age of thirty years, when they shall pay over and deliver to him the remainder of the Trust Fund.

Fifth. In case of the death of said Robert Douglas Stuart, Jr. before he shall receive all of the principal of the Trust Fund, leaving a child or children surviving, the Trustees shall pay over all or part, as the case may be, of the principal of the Trust Fund to such child, or in equal shares to such children. If in such case Robert Douglas Stuart, Jr. shall leave no child or children surviving, the Trustees shall pay over all or part, as the case may be, of the principal of the Trust Fund to the issue then surviving of the Donor, per stirpes. If, upon the death of said Robert Douglas Stuart, Jr., any beneficiary hereunder shall be a minor, then the Trustees shall apply so much of the income from the share of each such beneficiary for his or her support, maintenance and education as to the Trustees shall seem advisable, and in such man-

ner as to them shall seem best, and free from the con-
27 trol of any guardian, until he or she shall arrive at the age of twenty-one years. Thereafter they shall pay to him or her the income from his or her share until he or she shall arrive at the age of twenty-five years, when they shall pay over to such beneficiary the principal of his or her share, except that if any such beneficiary shall not attain the age of twenty-five years within twenty-one years from the death of the survivor of the Donor and Robert Douglas Stuart, Jr., then immediately before the expiration of such period of twenty-one years such beneficiary shall receive the principal of his or her share. In case of the death of any such beneficiary before he or she shall become entitled to receive the principal of his or her share of the Trust Fund, the Trustees shall immediately pay over his or her share thereof to the issue then surviving of said Robert Douglas Stuart, Jr., per stirpes, and if he shall leave no issue then surviving, to the issue then surviving of the Donor, per stirpes, and if there shall be then surviving no issue of Robert Douglas Stuart, Jr., or of the Donor, to Princeton University and Presbyterian Hospital of the City of Chicago in equal shares.

Sixth. In case of the death of the said Robert Douglas Stuart, Jr. before he shall receive all of the Trust Fund,
leaving surviving no child or children, and in case there
28 shall be then surviving no issue of the Donor, then the Trustees shall pay over all or part, as the case may be, of the principal of the Trust Fund in equal shares to Princeton University and Presbyterian Hospital of the City of Chicago.

Seventh. The interests by this Indenture created in either principal or interest shall not be grantable, transferable or otherwise assignable by anticipation, either by voluntary or involuntary act of any beneficiary, or by operation of law, and the said interests, or any part thereof, shall in no way or manner be liable for or be liable to be taken for any debt, liability or contract of any beneficiary whenever created, or be applied in any way or manner to the payment thereof, it being the intention of the Donor to assure the payment of the income during the terms specified, and the distribution of the principal as specified to the beneficiaries for their own individual use and benefit, and to limit their right hereunder to such sums as may become payable as to them as herein provided.

Eighth. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and delivering to the Trustees other property satisfactory to them of a market value at least equal to that of the property so withdrawn.

Ninth. During the life of the Donor, the said Harriet McClure Stuart and the said John Stuart, or the survivor of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect.

Tenth. The Trustees shall incur no liability or responsibility with respect to the validity of this Indenture, or any provisions thereof, or on account of any loss to or diminution in value of the property which may at any time constitute or be included in the Trust Fund, or on account of any other matter whatsoever, except such as may be due to their, his, her, or its actual fraud or willful mismanagement. The Trustees shall have a lien upon the income and principal of the Trust Fund for the reimbursement of any and all costs, expenses, and liabilities which they may incur or suffer by reason of this Indenture.

Eleventh. The Trustees, or any of them, may resign at any time by giving notice in writing of such resignation to the Donor during his life, and after his death by giving notice in writing of such resignation to the beneficiary or beneficiaries hereunder. In case of the resignation of one of the Trustees, or of his or her disability or incapacity to act further as Trustee, the remaining two Trustees shall have all the rights, powers, duties and authority granted to or imposed upon all of the Trustees under the provisions of this Indenture. In case of the resignation, disability or incapacity to act further of two or of three of the Trustees, then the First Union Trust

and Savings Bank, a corporation having its principal place of business in Chicago, Illinois, or its successor, shall act as joint Trustee or sole Trustee, as the case may be, with all of the rights, powers, duties and authority by this Indenture granted to or imposed upon an original Trustee, in case it shall act jointly, or granted to or imposed upon all the original Trustees, in case it shall act alone.

Twelfth. Wherever the word "Trustees" occurs herein, it shall be taken and held to embrace the Trustees or the Trustee for the time being under this Indenture, whether original or successor.

31 Thirteenth. In case the First Union Trust and Savings Bank shall act as a Trustee hereunder, it shall be entitled to receive reasonable compensation for its services.

Fourteenth. The Trustees hereby accept the Trust created by this Indenture upon and subject to the terms and conditions thereof.

Fifteenth. It is understood that this Indenture is made in the State of Illinois and governed by the laws thereof.

In Witness Whereof, the Donor and the Trustees have hereunto set their hand and seals.

Robert Douglas Stuart (Seal)
Donor.

Harriet McClure Stuart (Seal)
John Stuart (Seal)
Robert Douglas Stuart (Seal)
Trustees.

32 EXHIBIT 2.

Amendment of Indenture Made the 25th Day of March, 1932, Between Robert Douglas Stuart, of Lake Forest, Lake County, Illinois, (Therein Called the Donor), Party of the First Part, and Harriet McClure Stuart, of Lake Forest, Lake County, Illinois, John Stuart, of Winnetka, Cook County, Illinois, and Robert Douglas Stuart, the Donor, (Therein Called the Trustees), Parties of the Second Part, for the Benefit of Robert Douglas Stuart, Jr., Son of the Donor.

Thereas, in the Ninth paragraph of the Indenture made the 25th day of March, 1932, between Robert Douglas Stuart, of Lake Forest, Lake County, Illinois, (therein called the Donor), party of the first part, and Harriet McClure Stuart, of Lake Forest, Lake County, Illinois,

John Stuart, of Winnetka, Cook County, Illinois, and Robert Douglas Stuart, the Donor, (therein called the Trustees), parties of the second part, for the benefit of Robert Douglas Stuart, Jr., son of the Donor, it was provided as follows:

"Ninth: During the life of the Donor, the said Harriet McClure Stuart and the said John Stuart, or the survivor of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change, or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect."

Now, Therefore, the undersigned, the said Harriet McClure Stuart and the said John Stuart, being the persons mentioned in said paragraph "Ninth" hereby alter, change and amend said Indenture as follows:

First. Paragraph "Eighth" of said Indenture and all of the provisions of said paragraph are hereby cancelled and expunged so that said Indenture shall henceforth
33 be of the same effect as if said paragraph and the provisions thereof were not included therein.

Second. All of the provisions of said paragraph "Ninth" of said Indenture are hereby cancelled and expunged so that said Indenture shall henceforth be of the same effect as if the provisions of said paragraph were not included therein, and said paragraph "Ninth" is hereby changed and amended so that as changed and amended it shall read as follows:

Ninth: This Indenture and all of the provisions thereof are irrevocable and not subject to alteration, change or amendment.

In Witness Whereof, the undersigned have hereunto placed their hands and seals this 2 day of August, 1935.

Harriet McClure Stuart (Seal)
John Stuart (Seal)

The undersigned, as Trustees of the Trust created by the Indenture above described, hereby acknowledge the delivery to them of the foregoing Amendment to said Indenture.

August 6th, 1935 Harriet McClure Stuart
August 2—1935 John Stuart
August 6—1935 Robert Douglas Stuart

34 UNITED STATES BOARD OF TAX APPEALS.

• • (Caption—97501) • •

STATEMENT OF EVIDENCE FROM REPORTER'S MINUTES.

Filed May 29, 1941.

Hearing at Chicago, Illinois, on the 6th day of May, 1940, at 2:45 o'clock, P. M.

The above-entitled proceeding came on for hearing on Monday, the 6th day of May, 1940, before the Honorable Marion J. Harron, Member of the United States Board of Tax Appeals, at Chicago, Illinois, pursuant to notice of hearing heretofore given; whereupon, the following proceedings were had and testimony heard, to-wit:

EVIDENCE ON BEHALF OF PETITIONER.

Thereupon, the petitioner, to maintain the material averments of his petition, introduced the following proof:

MR. ROBERT DOUGLAS STUART, the petitioner herein, called as a witness on his own behalf, having been first duly sworn, was examined and testified as follows:

35 The Clerk: Will you please state your full name?
The Witness: Robert Douglas Stuart.

Direct Examination by Mr. Pope.

Q. Where do you reside, Mr. Stuart?
A. Lake Forest, Illinois.
Q. What is your occupation?
A. Oatmeal miller.
Q. What company are you associated with?
A. Quaker Oats Company.
Q. What is your position with that company?
A. First vice president.
Q. You are married and have four children?
A. I have.

Q. Were those children all minors at the time that the trust which it is stipulated you created in 1932 was made?

A. They were.

Q. Had you been in the habit, prior to the execution of this trust, of making any provision, or had you made any permanent provision for your children?

A. None.

Q. Can you state your reason, or the circumstances which induced you to make this trust at the time that you did?

Mr. Taylor: I object, if your Honor please, on the ground that this testimony is immaterial and irrelevant. The reason for making the gift, it seems to me, has nothing to do with the case.

36 The Member: Objection overruled.

Mr. Taylor: Exception.

The Member: Exception will be noted.

A. Well, I discussed trusts with my brother prior to his finally making his trust in 1930. It seemed to me that was the wise and sound procedure.

In my case, my children were all minors, the oldest being 15. Times were very uncertain, and I felt that while I had an opportunity to provide for them in the form of a trust that that was the wise thing to do.

By Mr. Pope:

Q. Were any changes made in the property that went into the trust prior to 1935?

A. None.

Q. Have there been any changes in the beneficiaries during the time of these trusts?

A. No.

Q. Can you state the relative values of the property that went into the trust and your net worth at the time the trust was created in 1932?

A. My net worth was around 3 million, and the property that went into the trust was approximately $600,000.

The Member: You mean that would be the total principal of the four trusts?

The Witness: Of the four trusts, yes.

Mr. Pope: I think that is all, if the Court please.

The Member: Any questions, Mr. Taylor?

Mr. Taylor: No, cross-examination.

37 MR. J. THEODORE FORRESTER, called as a witness by and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you please state your full name?
The Witness: J. Theodore Forrester.

Direct Examination by Mr. Pope.

Q. How are you employed, Mr. Forrester?
A. As secretary to Mr. John Stuart and Mr. R. Douglas Stuart.
Q. That is Robert Douglas Stuart?
A. Robert Douglas Stuart, right.
Q. Are you familiar with the trusts which Mr. Robert Douglas Stuart created in 1932?
A. Yes, I am.
Q. Can you tell us as to what amount of the income, if any, was distributed to the beneficiaries of the trusts, the four trusts created by him in 1932, during the balance of the year 1932 and during 1933?
A. Yes, I can.
Q. Will you do so, please?
A. There was none.
Q. There was no income distributed to the beneficiaries during those years?
A. That is right.
Mr. Pope: That is all.

38 The Member: Do you think that the words "by changing of beneficiary hereunder" mean any named beneficiary could be divested of his interest in the trust?
Mr. Pope: No, except for some good cause shown, which would appeal to a court of equity.
The Member: I think you are wrong. I think you are quibbling, and I think you are unwilling to face the question, and that doesn't do any good because, if you don't face the question today, you have to face it in your brief; and, if you don't face it in your brief, I am not going to decide this question by any method—
Mr. Pope: Will your Honor tell me what question I am not facing? What would you say, that we could name anybody?

The Member: I found nothing in this trust instrument that would prevent the trustees under the power making any person they chose a beneficiary of the trust. The terms are specific that the provision can be amended—

Mr. Pope: On that we would like—

The Member: (continuing) -to change the beneficiary hereunder at any time and from time to time.

Mr. Pope: All right. It is that question that we would like to—

The Member: I don't know of any other construction that can be put upon those terms excepting that you can omit Robert and substitute anyone, including the grantor of the trust or yourself, if the trustees wanted to substitute you.

39 Mr. Pope: It is on that question we would like to cite the authorities, if the Court please.

The Member: I would like to have you refer to any other provision of the trust instrument itself that would support your interpretation. I don't care what the authorities say in other cases about the terms of other trusts that have to be considered in relation to those other trusts. I want to know what the provisions of this trust are when taken in consideration with the words in Paragraph 9, what Paragraph 9 indicates that those words mean, whether anything other than more than is on their face.

Now, can you point out any provision in the other parts of this trust that limits the meaning of the words "to change the beneficiary?"

Mr. Pope: Yes, all the provisions of the trust and the purposes of the trust limit that.

The Member: What is the purpose?

Mr. Pope: That language must be construed in relation—

The Member: What is the purpose of the trust in the terms of the trust? I want you to cite that to me, the words that are in the trust that provide for that.

Mr. Pope: The purpose of the trust—

The Member: No. Mr. Pope, would you mind reading to me from the trust where you find that? I don't want your theory.

Mr. Pope: All I can do is read the trust all through, if your Honor wants me to spend the time in reading the trust through.

40 The Member: I would like you to read just what I asked for. Would you mind showing that to me?

Mr. Pope: All the provisions in the trust from the start to the finish, down to the final gift to Princeton University, or in this case the Presbyterian Church, every one of those means that the purpose of the trust is that the benefits, except as may be deemed provident by the trustees, are to go to the benefit of those persons named.

The Member: The word "provident" doesn't appear in the trust instrument anywhere that I can find.

Mr. Pope: I am simply saying that under the authorities and under the rules of courts of equity, anything that has been suggested by your Honor would be a violation of trust. That is exactly what I say, and I say—

The Member: It would be a violation of an irrevocable trust. I have told you already that there is a question of whether this is a revocable trust or an irrevocable trust.

Mr. Pope: It is not a revocable trust, because no such power is contained in the trust. Paragraph 9 does not make a revocable trust. What your Honor is suggesting is that language which doesn't use either the word "revocable" or "termination" can be construed as if they did, and our contention precisely is that you can't do that.

The Member: Well, Article 9 of the trust does not say that the trustees are limited to change the beneficiaries to those persons within the group named in the first in-
41 stance, for example. It doesn't say that the trustees have the right to change the share of the beneficiaries. It says that the trustees have the right to change the beneficiary. Beneficiary means a person, and the provision doesn't limit the persons who may become beneficiaries of the trust to any stated number or group of persons. So I certainly think that is a provision to be explained.

Herbert Pope,
Attorney for Petitioner.

Agreed to:
(S) J. P. Wenchel.

Filed Nov. 29, 1940. 42 UNITED STATES BOARD OF TAX APPEALS.

R. Douglas Stuart, Petitioner, *v.* Commissioner of Internal Revenue, Respondent.

Docket No. 97501. Promulgated November 29, 1940.

Petitioner in 1932 executed four indentures by which he created four trusts, one for the benefit of each of his four minor children. For the duration of petitioner's life, powers were given jointly to petitioner's wife and his brother, who were not beneficiaries of the trusts, to amend the trust indentures by changing the beneficiaries, or by changing the times for the distribution of corpora and income, or "in any other respect." Petitioner's wife and his brother amended the trust indentures on August 2, 1935, to provide that the trust indentures were "irrevocable and not subject to alteration, change or amendment." *Held*, that power was vested in petitioner's wife and his brother prior to the amendment to revest in petitioner title to the copora of the trusts; that petitioner's wife and his brother did not have substantial adverse interests in the disposition of the corpora of the trusts; and that petitioner was taxable during 1934 and during the period from January 1, 1935, to August 2, 1935, on the entire net income of the four trusts under section 166 (2) of the Revenue Act of 1934. *Fulham* v. *Commissioner*, 110 Fed. (2d) 916.

Herbert Pope, Esq., Preston B. Kavanagh, Esq., and *Benjamin M. Price, Esq.*, for the petitioner.

D. A. Taylor, Esq., for the respondent.

Respondent determined deficiencies of $19,323.70 and $13,715.38 in income tax for the years 1934 and 1935, respectively. The basic question is whether petitioner was taxable in 1934 and in the first seven months of 1935 on the entire net income of four trusts which he created for the benefit of his four minor children. Another adjustment made by respondent to the income reported by petitioner in his income tax return for 1935 is not contested.

Findings of Fact.

Petitioner is a resident of Lake Forest, Illinois, and filed his income tax return for each of the years 1934 and 1935 with the collector of internal revenue for the first district of Illinois.

Petitioner and his wife, Harriet McClure Stuart, have four children: Robert, born April 26, 1916; Anne, born January 11, 1920; Margaret, born January 3, 1922; and Harriet, born February 3, 1928.

On March 25, 1932, petitioner executed four indentures by which he created four separate trusts, one for the benefit of each of his four children. In the trust indentures petitioner named himself, his wife, and his brother, John Stuart, as the trustees of each trust. To the trustees of each trust petitioner transferred 1,500 shares of the common stock of the Quaker Oats Co. of which petitioner was first vice president.

The provisions of each of the four trust indentures were substantially the same. Until the child designated as the beneficiary of the particular trust became 30 years of age (25 years of age in the case of the trust for petitioner's son), the trustees were to pay over to the beneficiary, or were to apply for the beneficiary's education, support, and maintenance, so much of the net income of the trust as seemed advisable to the trustees, and were to add the unexpended portion of the net income of the trust to the principal of the trust. When the beneficiary became 30 years of age (25 years of age in the case of the trust for petitioner's son), the trustees were to pay over to the beneficiary one-half of the principal of the trust. Thereafter, the trustees were to pay over to the beneficiary the net income from the remaining one-half of the principal of the trust until the beneficiary became 35 years of age (30 years of age in the case of the trust for petitioner's son), when the trustees were to pay over to the beneficiary the remaining one-half of the principal of the trust.

In the event of the beneficiary's death before receiving all of the principal of the trust, the trustees were to pay over the remaining principal to the beneficiary's children; or, if the beneficiary left no children surviving, to petitioner's issue then surviving; or, if the beneficiary left no children surviving and there were then surviving no issue of petitioner, to Princeton University and the Presbyterian Hospital of the city of Chicago in equal shares.

The trustees were empowered to collect all income; to sell any of the securities held in trust; to invest the proceeds from the sale of securities and the net income added to trust principal in "municipal or government bonds, stocks, real estate mortgages, or other income producing property or securities, real or personal * * * without being limited or restricted to investments as fixed by the statutes of the State of Illinois"; to execute all necessary "assignments, conveyances, deeds and other instruments"; to exercise the voting power upon all shares of stock held in trust; to exercise "every power, election and discretion, give every notice, make every demand, and do every act and thing in respect of any shares of stocks and bonds which they could or might do if they were absolute owners thereof"; to unite with others "in carrying out any
43 plan for the reorganization of any corporation" the securities of which were held in trust; to exchange the securities of any corporation for others issued by any corporation; to assent to the consolidation or merger of any corporation; to pay "such assessments, expenses and sums of money as they may deem expedient for the protection of the interest" of the trust in the securities of any corporation; and to employ "such agents and attorneys as may be necessary."

Stock dividends, liquidating dividends, and "proceeds from the sale of any part of the Trust Fund, including profits" were to constitute principal.

Each trust indenture contained a clause providing that the trustees were not to incur any liability "except such as may be due to * * * actual fraud or willful mismanagement", and a clause providing that any person dealing with the trustees was not to be required "to see to the application of any money or monies paid to the Trustees."

Paragraphs eighth and ninth of each trust indenture provided as follows:

> Eighth. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and delivering to the Trustees other property

satisfactory to them of a market value at least equal to that of the property so withdrawn.

Ninth. During the life of the Donor, the said Harriet McClure Stuart and the said John Stuart, or the survivor of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect.

On August 2, 1935, Harriet McClure Stuart, petitioner's wife, and John Stuart, petitioner's brother, executed an amendment to each of the four trust indentures, canceling paragraph eighth and changing paragraph ninth to read as follows: "Ninth. This Indenture and all the provisions thereof are irrevocable and not subject to alteration, change or amendment."

During the period from March 25, 1932, to August 2, 1935, no changes were made in the beneficiaries of the four trusts or in the property held by the trusts.

On the fiduciary income tax returns filed by the trustees of the four trusts for the years 1934 and 1935 the net income of each of the trusts was reported as follows:

Trust for—	1934	1935
Robert	$9,207.91	$9,859.20
Anne	9,208.23	9,787.46
Margaret	9,201.81	9,782.17
Harriet	9,226.20	9,788.20

In 1934 and 1935 the entire net income of the trusts for Anne, Margaret and Harriet was added to the principal of the respective trusts. In 1934 and 1935 $1,391.50 and $1,882.50 of the net income of the trust for Robert was distributed to him and the balance of the net income was added to the principal of the trust.

In 1934 the total net income of the four trusts was $37,162.91, and in 1935 the total net income of the four trusts was $39,217.03, of which amount $25,831.15 was received by the trustees during the period from January 1 to August 2, 1935.

Petitioner's net income (not including any income of the four trusts) was $117,153.17 in 1934 and $175,794.47 in 1935.

At the time of the creation of the four trusts, petitioner's net worth was approximately $3,000,000 and the property which he transferred to the trusts had a value of approximately $600,000.

Opinion.

HARRON: The basic question is whether petitioner was taxable in 1934 and in the first seven months of 1935 on the entire net income of the four trusts which he created for the benefit of his four minor children.

In computing the deficiencies in petitioner's income tax for 1934 and 1935, respondent included in petitioner's taxable income the entire net income of the four trusts during 1934 and during the period from January 1 to August 2, 1935, on which date the trust indentures were amended to provide that they were "irrevocable and not subject to alteration, change or amendment." In the deficiency notice respondent grounded his determination on section 166 (2) of the Revenue Act of 1934. In an amended answer and in his brief respondent supports his determination under sections 167 (a) and 22 (a) of the Revenue Act of 1934, as well as under section 166 (2).

The pertinent provisions of section 166 (2) of the Revenue Act of 1934 are as follows:

> Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—
>
> * * * * * *
>
> (2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,
>
> then the income of such part of the trust shall be included in computing the net income of the grantor.

44 Respondent contends that section 166 (2) is applicable because under paragraph ninth of the trust indentures power was vested in petitioner's wife and his brother to revest title to the corpora of the trusts in petitioner and because petitioner's wife and his brother did not have substantial adverse interests in the disposition of the corpora of the trusts or the income therefrom. Petitioner asserts that no power to revest title to the corpora of the trusts in petitioner was vested in petitioner's wife and his brother under paragraph ninth, and that even if such power were vested in petitioner's wife and brother, they had sub-

stantial adverse interests in the disposition of the corpora of the trusts and the income therefrom.

In support of his assertion that no power to revest title to the corpora of the trusts in petitioner was vested in petitioner's wife and his brother under paragraph ninth, petitioner argues that the powers given to petitioner's wife and his brother under that paragraph could be exercised only in the interests of the beneficiaries named in the trust indentures. Petitioner points to the fact that under the trust indenture no power is given expressly to his wife and his brother to revest title to the corpora of the trusts in him, that he is not named as a beneficiary in the trust indentures, and that under paragraph eighth of the trust indentures he is given a power to withdraw the whole or any part of the corpora of the trusts *only* upon first delivering to the trustees other property satisfactory to the trustees "of a market value at least equal to that of the property withdrawn." Petitioner relies on *Higgins* v. *White*, 93 Fed. (2d) 357; *Knapp* v. *Hoey*, 24 Fed. Supp. 39; affd., 104 Fed. (2d) 99; *Phebe Warren McKean Downs*, 36 B. T. A. 1129; and *Ellsworth B. Buck*, 41 B. T. A. 99.

To determine whether under paragraph ninth power was vested in petitioner's wife and his brother to revest title to the corpora of the trusts in petitioner, that paragraph must be interpreted in accordance with the intent of the petitioner as gathered from the trust indentures in their entireties. *Ellsworth B. Buck, supra.* It is sufficient if the powers given to petitioner's wife and his brother under paragraph ninth amounted *in fact* to a power to revest title to the corpora of the trusts in petitioner. *Ralph Pulitzer*, 36 B. T. A. 964; cf. *Bowler* v. *Helvering*, 80 Fed. (2d) 103.

An examination of paragraph ninth in the light of the principles set forth above compels the conclusion that petitioner's wife and his brother had the power to revest title to the corpora of the trusts in petitioner within the meaning of section 166 (2). Under paragraph ninth of each trust indenture, petitioner's wife and his brother were given "full power * * * to alter, change or amend this indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, * * * or in any other respect." Under the provisions of paragraph ninth the powers given to petitioner's wife and his brother were absolute, and these abso-

lute powers were not limited by any other provisions of the trust indentures. Cf. *Fulham* v. *Commissioner*, 110 Fed. (2d) 916. The provisions of paragraph eighth limited only the right which petitioner reserved in that paragraph to withdraw the corpora of the trusts and did not limit the absolute powers granted to petitioner's wife and his brother in paragraph ninth. As donees of absolute powers, petitioner's wife and his brother could exercise the powers in favor of petitioner. See *Frank* v. *Frank*, 305 Ill. 181; 137 N. E. 151; Perry, Trusts and Trustees, 7th ed., vol. I, p. 453; Farwell, Powers, 2d ed., p. 8. Since under paragraph ninth petitioner's wife and his brother had the power at any time to amend the trust indentures to make petitioner the sole beneficiary of the trusts and to provide for immediate distribution of the corpora to him, they had, in fact, the power to revest in petitioner title to the corpora of the trusts within the meaning of section 166 (2). Cf. *Ralph Pulitzer, supra.*

The cases relied on by petitioner in support of his argument that the powers given to petitioner's wife and his brother under paragraph ninth were limited are distinguishable. In *Higgins* v. *White, supra*, the power to revest the corpus in the grantor, which was vested in the grantor and his cotrustees, was to be exercised only if "the trustees shall deem it wise so to do" and was thus a fiduciary power as distinguished from an absolute power. See *Fulham* v. *Commissioner, supra.* In *Knapp* v. *Hoey, supra; Phebe Warren McKean Downs, supra;* and *Ellsworth B. Buck, supra*, the grantor included in the trust indenture an express provision to the effect that the trust was irrevocable.

Petitioner argues next that, if the powers given to his wife and his brother under paragraph ninth were so broad that they had the power to revest in petitioner title to the corpora of the trusts, they also had the power to amend the trust indentures to make themselves the beneficiaries of the trusts, and thus had substantial adverse interests in the disposition of the corpora of the trusts and the income therefrom within the meaning of section 166 (2). In support of this argument petitioner relies on *Laura E. Huffman*, 39 B. T. A. 880.

On March 25, 1932, the date on which the trusts were created, section 166 of the Revenue Act of 1928 had not yet been amended by the Revenue Act of 1932 and provided that the grantor of a trust was taxable on the trust income

where he had "at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust." In the trust indentures petitioner reserved no power to revest in himself title to any part of the corpora of the trusts either alone or in conjunction with his wife and brother. Shortly after the trusts were created section 166 was amended by the Revenue Act of 1932. For present purposes section 166 was substantially the same under the 1934 Act as under the 1932 Act. The legislative purpose for the amendment of section 166 in the 1932 Act was "to block a possible means of tax avoidance by the device of vesting the power to revoke the trust in some person other than a beneficiary, whereby in fact the grantor may retain 'substantially the same control as if he alone had power to revoke the trust'." *Fulham* v. *Commissioner, supra;* see Report of the Senate Committee on Finance, S. Rept. No. 665, 72d Cong., 1st sess., p. 34.

In *Fulham* v. *Commissioner, supra,* the taxpayer conveyed certain property in trust to himself and another as cotrustees. The trustees were to accumulate the income of the trust until the death of the taxpayer's wife. During the life of the taxpayer's wife the trustees were empowered to pay her "at any time or from time to time any part or parts or the whole of the principal and/or accumulated income" of the trust. After the death of the taxpayer's wife the trustees were to pay the income, and eventually the principal, to the children of the taxpayer and their issue. Power to revoke the trust and revest the corpus in the taxpayer was vested in a committee subject to the consent of the taxpayer's wife. Petitioner conceded that the committee did not have a substantial adverse interest in the disposition of the corpus or the income therefrom, but maintained that the taxpayer's wife did have such a substantial adverse interest. In holding that the taxpayer's wife did not have a substantial adverse interest in the disposition of the corpus or the income therefrom within the meaning of section 166 (2) of the Revenue Act of 1934, the Circuit Court stated in part as follows:

> The evident policy of the Revenue Act is to tax the income to the grantor of a trust when he retains the substantial mastery over the corpus. Even though in form he lodges the power of revocation in someone other than himself, Section 166 is founded on the rea-

> sonable premise that the grantor still retains practical mastery, when this power is given to someone having no stake in the trust, or a stake so insubstantial that the holder of the power would not improbably be amenable to the grantor's wishes. This calls for a realistic appraisal.
>
> • • • • •
>
> Upon appraisal of the trust instrument against a background of realities, we are convinced that this is a typical arrangement, falling within Section 166, where the grantor retains the controlling hand over something he has seemed to give away.

In considering whether the taxpayer's wife had a substantial adverse interest within the meaning of section 166 (2), the Circuit Court in the *Fulham* case stated that the observations of the Supreme Court in *Helvering* v. *Clifford*, 309 U. S. 331, were pertinent, though made in respect to section 22 (a). In the *Clifford* case the taxpayer declared himself trustee of certain property. The trust was to terminate at the end of five years or on the earlier death of the taxpayer or his wife. During the continuance of the trust the taxpayer was to pay over to his wife the whole or such part of the net income as he in his "absolute discretion" might determine. On termination of the trust the entire corpus was to go to the taxpayer and all undistributed net income was to go to his wife. During the continuance of the trust the taxpayer retained broad powers of control over the corpus. During the year 1934 all the trust income was distributed to the taxpayer's wife. The parties stipulated that the taxpayer's wife had substantial income of her own from other sources; that there was no restriction on her use of the trust income; that the trust was not designed to relieve the taxpayer from liability for family or household expenses; and that after the creation of the trust the taxpayer paid large sums from his personal funds for family and household expenses. The Supreme Court held that the taxpayer was taxable on the income of the trust under section 22 (a) of the Revenue Act of 1934. The Supreme Court stated in part that "the short duration of the trust, the fact that the wife was the beneficiary, and the retention of control over the corpus by respondent all lead irresistibly to the conclusion that respondent continued to be the owner for purposes of section 22 (a)", and made the following observation:

> • • • To hold otherwise would be to treat the

wife as a complete stranger; to let mere formalism obscure the normal consequences of family solidarity; and to force concepts of ownership to be fashioned out of legal niceties which may have little or no significance in such household arrangements.

To determine whether petitioner's wife and his brother had substantial adverse interests within the meaning of section 166 (2), the trust indentures must be appraised "against a background of realities," *Fulham* v. *Commissioner, supra.* The record in this proceeding does not furnish by itself a complete background of "realities." Although this proceeding and the proceeding brought by petitioner's brother, John Stuart, Docket No. 97500, were not consolidated for hearing, this proceeding was heard immediately after the proceeding brought by petitioner's brother and the two proceedings admittedly involve substantially similar questions and facts. Therefore, in order to appraise the trust indentures against a complete background of "realities" the Board may notice the record in the proceeding brought by petitioner's brother. *O'Donnell* v. *United States*, 91 Fed. (2d) 14; Wigmore, Evidence, 3d ed., 1940, sec. 2579. The record in the proceeding brought by petitioner's brother shows, *inter alia*, that in 1930 petitioner's brother executed three trust indentures by which he created three separate trusts, one for the benefit of each 46 of his three children; that petitioner's brother named himself, his wife, and petitioner as the trustees of each trust; that petitioner's brother was the president of the Quaker Oats Co.; that petitioner's brother transferred 700 shares of the common stock of the Quaker Oats Co. to the trustees of each trust; that the provisions of each of the three trust indentures executed by petitioner's brother were substantially the same as the provisions of the four trust indentures executed by petitioner; that under paragraph ninth of the three trust indentures executed by petitioner's brother the very same powers were given to his wife and to petitioner as were given to petitioner's wife and his brother under paragraph ninth of the four trust indentures executed by petitioner; and that on August 3, 1935, the wife of petitioner's brother and petitioner executed an amendment to the three trust indentures executed by petitioner's brother changing paragraph ninth to provide that the trusts were "irrevocable and not subject to alteration, change or amendment."

An appraisal of the trust indentures against a background of "realities" thus completed by the record in the proceeding brought by petitioner's brother leads to the conclusion that petitioner's wife and his brother did not have substantial adverse interests in the disposition of the corpora of the trusts or the income therefrom within the meaning of section 166 (2). Petitioner's wife and his brother had no actual stakes in the trusts as beneficiaries. Cf. *Corning* v. *Commissioner*, 104 Fed. (2d) 329; *Laura E. Huffman, supra;* and *Daniel P. Woolley*, 39 B. T. A. 802. At best they had only potential stakes in the trusts by reason of the powers given them under paragraph ninth. However, the powers under paragraph ninth were given them only for the duration of petitioner's life, cf. *Laura E. Huffman, supra;* and during their joint lives the powers under paragraph ninth could be exercised only by their joint action. See *Bowler* v. *Helvering, supra.*

In the light of the "realities", the potential stakes which petitioner's wife and his brother had in the trusts were so insubstantial that they "would not improbably be amenable to the grantor's wishes." *Fulham* v. *Commissioner, supra.* The interests of petitioner's wife and his brother appear to be identical with those of petitioner. Cf. *Laura E. Huffman, supra.* With respect to the interests of petitioner's wife, the observations made by the Supreme Court in *Helvering* v. *Clifford, supra,* are as pertinent here as they were in *Fulham* v. *Commissioner, supra.* There is no more ground here for treating petitioner's wife as a complete stranger than there was in the *Clifford* or *Fulham* cases. The stake of petitioner's wife in the trusts here was no more substantial than was the stake of the taxpayer's wife in the trust in the *Fulham* case. To hold that the interests of petitioner's wife were adverse to those of petitioner would be "to let mere formalism obscure the normal consequences of family solidarity." *Helvering* v. *Clifford, supra.* Furthermore, the interests of petitioner's brother were not only linked to those of petitioner by a close family relationship, but by a close business relationship as well. Petitioner and his brother were, respectively, the first vice president and the president of the Quaker Oats Co. The original corpora of the four trusts created by petitioner and of the three trusts created by his brother consisted of common stock of the Quaker Oats Co. Petitioner was one of the trustees of the three trusts created by his brother, and his brother was one of the trustees of the four trusts.

created by petitioner. In the four trusts created by petitioner the donees of the power to revest title in him were his wife and his brother, and in the three trusts created by petitioner's brother the donees of the power to revest title in him were his wife and petitioner. The natural result of this cross-relationship was that petitioner's brother would be amenable to the wishes of petitioner in the conduct of the four trusts created by petitioner and that petitioner, in turn, would be amenable to the wishes of his brother in the conduct of the three trusts created by his brother. That the interests of petitioner's wife and his brother were identical with those of petitioner is borne out by the fact that on August 2, 1935, petitioner's wife and his brother executed an amendment to each of the trust indentures which provided that each of the trust indentures was "irrevocable and not subject to alteration, change or amendment", and thus destroyed whatever potential stakes in the trusts they had prior thereto, and also by the fact that on August 3, 1935, petitioner and the wife of his brother executed a similar amendment to each of the trust indentures executed by his brother. Against such a background of "realities" it cannot be held that the potential stakes which petitioner's wife and his brother had in the trusts clothed them with substantial adverse interests within the meaning of section 166 (2). *Fulham* v. *Commissioner*, *supra*.

Since under paragraph ninth of the trust indentures power to revest in petitioner title to the corpora of the trusts was vested in his wife and his brother, and since his wife and his brother did not have substantial adverse interests in the disposition of the corpora of the trusts or the income therefrom, it is held that petitioner was taxable on the entire net income of the trusts during 1934 and during the period from January 1 to August 2, 1935, under section 166 (2) of the Revenue Act of 1934. *Fulham* v. *Commissioner*, *supra*. In view of this conclusion it is not necessary to consider the further contentions made by respondent that petitioner was also taxable on the entire net income of the trusts during the period in question under sections 167 (a) and 22 (a) of the Revenue Act of 1934.

Decision will be entered under Rule 50.

Entered Jan. 14, 1941. 47 UNITED STATES BOARD OF TAX APPEALS.

• • • (Caption—97501) • •

DECISION.

Pursuant to the determination of the Board, as set forth in its Findings of Fact and Opinion, promulgated November 29, 1940, and in accordance with the recomputation under Rule 50 filed by respondent December 17, 1940, in which counsel for petitioner acquiesces, it is

Ordered and Decided: That there are deficiencies in income tax liability as follows: for the year 1934 there is a deficiency of $19,323.70, and for the year 1935 there is a deficiency of $13,715.38.

(s) Marion J. Harron,
Member.

(Seal)

Entered January 14, 1941.

Filed Apr. 3, 1941. 48 UNITED STATES BOARD OF TAX APPEALS.

• • (Caption—97501) • •

PETITION FOR REVIEW AND STATEMENT OF POINTS.

Filed April 3, 1941.

The above named petitioner, by his attorneys, hereby files this petition for a review of the decision of the United States Board of Tax Appeals entered in January 14, 1941, in the above entitled cause, together with his statement of points.

1. The taxable years involved are the calendar years 1934 and 1935.

2. The petitioner filed his income tax return for each of said years with the Collector of Internal Revenue at Chicago, Illinois.

3. The petitioner seeks review of said decision of the United States Board of Tax Appeals by the United States Circuit Court of Appeals for the Seventh Circuit.

Statement of Points.

4. In seeking such review the petitioner files this his statement of points:

49 (1) The Board of Tax Appeals erred in holding that the income of the four trusts involved in this case was taxable to the petitioner under the provisions of section 166(2) of the Revenue Act of 1934.

(2) Under the evidence in this case the Board of Tax Appeals erred in concluding that power was vested in the petitioner's wife and brother, who were trustees of the trusts, to revest the principal of the trusts in the petitioner, who was the grantor and not a beneficiary of the trusts.

(3) The conclusion of the Board of Tax Appeals as to the unlimited power of the petitioner's wife and brother defeats the tax in this case. If the petitioner's wife and brother had the power, as the Board held, to revest the principal of the trusts in the petitioner, then the Board erred in failing to hold that the income of the trusts was not taxable to the petitioner under section 166(2) of the Revenue Act of 1934 because the petitioner's wife and brother had a substantial adverse interest to such revesting of principal in the petitioner in that they had an unlimited power to modify the trusts and accordingly could cause income or principal to be paid to themselves.

(4) The Board of Tax Appeals erred in holding that there is a deficiency in income tax owing by the petitioner for the year 1934 in the amount of $19,323.70 and for

50 the year 1935 in the amount of $13,715.38.

(5) The decision of the Board of Tax Appeals is not supported by any substantial evidence and is contrary to the evidence.

Wherefore, the petitioner prays that the said decision of the United States Board of Tax Appeals be reviewed and reversed and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected.

Herbert Pope,
Herbert Pope,
Benjamin M. Price,
Benjamin M. Price,
Preston B. Kavanagh,
Preston B. Kavanagh,
Attorneys for Petitioner,
120 South La Salle Street,
Chicago, Illinois.

Filed Apr. 5, 1941. 51 IN THE UNITED STATES CIRCUIT COURT OF APPEALS

For the Seventh Circuit.

R. Douglas Stuart,
Petitioner on Review.
vs.
Commissioner of Internal Revenue,
Respondent on Review.
} B. T. A. Docket No. 97501.

NOTICE OF FILING PETITION FOR REVIEW AND STATEMENT OF POINTS.

Filed April 5, 1941.

To: J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

You are hereby notified that R. Douglas Stuart did, on the 3rd day of April, 1941, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Seventh Circuit, of the decision of the Board heretofore rendered in the above entitled case. Copies of the petition for review and the statement of points as filed are hereto attached and served upon you.

Dated this 3rd day of April, 1941.

(S.) B. D. Gamble,
B. D. Gamble,
Clerk, U. S. Board of Tax Appeals.

Service of copy of Petition for Review and Statement of Points acknowledged this 5th day of Apr., 1941.

J. P. Wenchel.

52 UNITED STATES BOARD OF TAX APPEALS. Filed May 29, 1941.

R. Douglas Stuart,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.
} Docket No. 97,501.

PRAECIPE FOR RECORD.

Filed May 29, 1941.

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit copies duly certified as correct of the following documents and records in the above entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Seventh Circuit heretofore filed by the petitioner:

1. Docket entries of the proceedings before the Board in this case.

2. Pleadings before the Board in this case:

(a) Petition.

(b) Answer to petition.

(c) Amendment to answer.

53 3. Findings of fact and opinion of the Board, promulgated November 29, 1940.

4. Decision of the Board entered January 14, 1941.

5. Petition for review and statement of points, with proof of service.

6. Stipulation of facts, including exhibits, filed May 6, 1940.

7. The agreed statement of evidence being the following portions of the official report of the hearing in this case on May 6, 1940:

(1) Commencing on page 5 with "Evidence on Behalf of Petitioner" and ending on page 8 with the words "No cross-examination";

(2) Testimony of J. Theodore Forrester, commencing on page 17 and ending on page 18;

(3) Commencing on page 29 at eighth line from bottom of page and continuing to page 33, ending with the fifth line thereof.

8. This praecipe.

Herbert Pope,
Attorney for Petitioner.

Agreed to:
(S.) J. P. Wenchel.

54 UNITED STATES BOARD OF TAX APPEALS.

• • (Caption—97501) • •

CERTIFICATE.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 58, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 5th day of June, 1941.

B. D. Gamble,
Clerk, United States Board of Tax Appeals.

(Seal)

55 UNITED STATES BOARD OF TAX APPEALS. Entered May 6, 1941.

• • (Caption—97501) • •

ORDER ENLARGING TIME.

On motion of counsel for petitioner and consent of counsel for the respondent, it is

Ordered that the time for preparation of the evidence and for transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit be and it is hereby extended to June 12, 1941.

(Signed) C. R. Arundell,
Member.

Dated: Washington, D. C.
May 6, 1941.

s

Now, June 5, 1941, the foregoing is certified from the record as a true copy.

B. D. Gamble,
B. D. Gamble,
Clerk, U. S. Board of Tax Appeals.

(Seal)

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing printed pages contain a true copy of the printed record, printed under my supervision and filed on the ninth day of July, 1941, in the following cause: No. 7696, R. Douglas Stuart v. Commissioner of Internal Revenue, respondent, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this thirteenth day of February, A. D. 1942.

[SEAL] KENNETH J. CARRICK,
Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit held in the City of Chicago and begun on the first day of October in the year of our Lord one thousand nine hundred and forty, and of our Independence the one hundred and sixty-fifth.

7696

R. DOUGLAS STUART, PETITIONER
vs.
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board of Tax Appeals

And, to wit: On the nineteenth day of December, 1941, there was filed in the office of the Clerk of this Court, the opinion of the court, which said opinion is in the words and figures following, to wit:

546

In the United States Circuit Court of Appeals for the Seventh Circuit

October Term and Session, 1941

No. 7695

JOHN STUART, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

No. 7696

R. DOUGLAS STUART, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petitions for Review of Decisions of the United States Board of Tax Appeals

December 19, 1941

Before SPARKS, MAJOR, and MINTON, Circuit Judges.

SPARKS, Circuit Judge: These petitions seek to review decisions of the United States Board of Tax Appeals. We shall treat them in the order of their numbers.

In the case of John Stuart, the Commissioner determined income tax deficiencies against him for the years 1934 and 1935. The Board confirmed that ruling and held that under Section 166 (2) of the Revenue Act of 1934, petitioner was taxable on the net income of three trusts which he had created in 1930 for the benefit of his three children.

The evidence comprised a stipulation of facts and petitioner's testimony, which substantially is as follows:

On March 31, 1930, petitioner executed three trust agreements, one for his daughter Joan, who had just been married; one for another daughter, Ellen, who was about to be and is now married; and one for his son, John. In 1934 all three children were over twenty-one years of age.

Petitioner created the trusts because he felt that the daughters ought to be made independent so that they could conduct their homes in a reasonable manner. He had been giving his children allowances, a plan which he did not approve, particularly after marriage. He appointed his wife, Ellen Shumway Stuart, his brother Robert Douglas Stuart, and himself as

trustees of each trust. His reason for appointing his wife and brother was that he knew that they shared his point of view in regard to the children, their needs, and how he wanted them to live, and that they would be just as strict in dealing with the children as he would be. He thought the children's interests would be better served and protected by having them as trustees than by having a corporate trustee. They knew that the trusts were created entirely for the beenfit of the children, and the petitioner felt sure that as trustees they would resist any attempt by anyone to change that objective.

Petitioner's net worth, at the time the trusts were created, exceeded $4,000,000 exclusive of the trust property which was worth about $575,000. Each trust made the same provision for each child and each comprised 700 shares of common stock of the Quaker Oats Company, of which petitioner was president.

For the first fifteen years the trustees were to pay to the child designated as the beneficiary of the particular trust so much of the net income as in the discretion of the trustees they should deem advisable, and they were directed to add any undistributed income to the principal of the trust. After fifteen years the trustees were to pay the entire net income to such child. Upon the death of a child the trustees were to pay the principal of the trust to that child's issue then living, or, if there were no such issue, then to the issue of the petitioner then living, or, if there were no such issue then living, then in equal shares to Princeton University and the University of Chicago. The trustees were given the usual broad powers of management and administration. There was a spendthrift clause, a clause exonerating the trustees from liability except for fraud or willful mismanagement, a provision appointing a trust company as a co-trustee if two of the trustees should resign, and a provision that the trust should be governed by the laws of the State of Illinois.

The eighth and ninth articles of each indenture provided as follows:

"Eight. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and delivering to the Trustees other property satisfactory to them of a market value at least equal to that of the property so withdrawn.

"Ninth. During the life of the Donor, the said Ellen Shumway Stuart and the said Robert Douglas Stuart, or the survivor of them, shall have full power and authority, by an instrument in

writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the trustees, or in any other respect."

On August 3, 1935, taxpayer's wife and brother, above named, executed an amendment to each of the three trust indentures cancelling the eighth article and changing the ninth to read as follows:

"Ninth. This Indenture and all of the provisions thereof are irrevocable and not subject to alteration, change or amendment."

The total net income of the three trusts for 1934 was $22,560.02. Of this, Joan and Ellen each received the full shares of $7,496.74. There was distributed to John for that year $1,863.33, and there remained in his trust an undistributed amount of $5,703.21. For 1935 there was a total net income of the trusts of $25,725. Of this, the trusts of Joan and Ellen were each entitled to $8,295, and John's trust was entitled to $9,135. There was a partial distribution which left undistributed balances of income for this year due the trusts in the order named, the respective sums of $619.64; $821.20; and $6,394.50.

The Commissioner determined that the net income from each of the three trusts for 1934, and from January 1, 1935, to August 3, 1935, the date of the amendment was taxable to the taxpayer, and upon that basis determined the deficiency. The Board sustained the Commissioner.

The Commissioner, in support of the Board's ruling, relies upon Section 166 of the Revenue Act of 1934, the material part of which reads as follows:

"Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested

* * * * * *

"(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom 'then the income of such part of the trust shall be included in computing the net income of the grantor.'"

Under this section the Commissioner contends that the terms of each indenture require the conclusion that there were no fiduciary restrictions upon the power of the taxpayer's wife and brother to revest the corpus of each trust in the taxpayer. Furthermore, he contends that the taxpayer's wife and brother had no interests in the property which were substantially adverse to those of the taxpayer, and this he asserts to be true in view of family and business relationships, and the existence of an identi-

cal power in the taxpayer and his brother's wife with respect to trusts executed by his brother for the benefit of his own children.

The Commissioner bases his argument upon the premise that "if there is any possibility that the grantor (John Stuart) might become revested with the corpus of the trust the income is taxable to him." He asserts that this premise is contained in Treasury Regulations 86 under section 167 ("which provides for the taxation of the income of a trust to the grantor if he has retained an interest in the income thereof"), and that this regulation should be applied to section 166 which complements section 167. He further states that the test contained in his premise has been unanimously applied to section 167 by all the Circuit Courts of Appeal to which the question has been presented, including this court. See Graff v. Commissioner, 117 F. 2d 247. All the cases cited support the treasury regulation. However, none of them support the Commissioner's premise, because it is not supported either by the regulation or the Statute. The key thought of the Commissioner's premise is merely the *possibility* of *reinvestiture*. The "single test" of the regulation for section 166, is "whether the grantor has failed to *divest himself* * * * of every right which might by any possibility enable *him* once more to possess and *enjoy in title* the trust corpus." [Our italics.] It is only in case the grantor has retained any such interest that he is taxable with respect to the income of the trust. His reinvestiture must be based on some right which he has retained ab initio.

In the instrument before us, the grantor neither reserved nor retained any right which might by any possibility enable him to repossess or enjoy in title the trust property. True, in article eight he reserved the right at any time and from time to time to withdraw and take over to himself the whole or any part of the trust fund, but before doing so he must transfer and deliver to the trustees other property satisfactory to them, of a market value at least equal to that of the property so withdrawn. It is not denied that this provision was inserted to preserve to the trust the benefit of the grantor's vast knowledge and experience, and yet any such shifting or trading of investments must first be approved by the other trustees, and in no other respect was their power to invest or reinvest disturbed. This of course was a retention of a right, although not an exclusive one, yet it was not such a right as could by any possibility enable the grantor to possess and enjoy in title the trust corpus. It was merely the right to make an offer to exchange securities which could not be enforced by the grantor without the consent of the other trustees.

The Commissioner contends, however, that John Stuart's right to recapture the corpora of these trusts is found in the exercise of the other trustees' discretion, as set forth in the original ninth article. He does not contend that this is either a legal, an equitable, or a moral right which the grantor could enforce, but he insists that because of the cross relationship between the grantor and his brother, R. Douglas Stuart, a trustee, the latter would be amenable to the wishes of the grantor. This cross relationship, aside from consanguinity and business relations, also contemplates the fact that almost two years subsequent to the declaration of the John Stuart trusts, his brother R. Douglas Stuart, declared a trust primarily for the benefit of his children in which he had named himself and his wife and petitioner as the trustees with substantially the same powers as those given to the trustees in the John Stuart trusts. Likewise the Commissioner insists that because of the marital relation between petitioner and his wife, she would be amenable to his wishes even to the point of depriving her own children of their rightful and perhaps needed allowance. Assuming without admitting such effect of these cross relationships as a legal conclusion, we submit that under such circumstances the recapture of the corpora of the trusts by petitioner would be by virtue of the future exercise of his influence over the other trustees and not by virtue of any right which he reserved or failed to grant at the time of his declaration, which is the "single tests" promulgated by the Treasury Regulation.

We are not dealing here with technical considerations, niceties of the law, or the legal paraphernalia which inventive genius has constructed as a refuge from surtaxes. There is no inventive genius here; it is all quite old in the art. Congress, long ago and quite clearly, described the issue, and the Treasury Department, in unambiguous language, promulgated a regulation which laid down just one test for us to follow in determining the taxpayer's liability, if any.

The basic question then is whether the grantor by his original declaration "failed to divest himself * * * of every right which might by any possibility enable him once more to possess and enjoy in title the trust corpus." If he failed to do so he can not prevail here. If he did not thus fail he should prevail, even though as a result, his surtaxes may have been minimized. We fully appreciate that nothing should obscure this basic issue, and we feel assured that the mere decrease in the amount of the grantor's surtaxes is not sufficient to authorize us to alter the plain words of the Statute and the Treasury Regulations under the guise of judicial construction. To lawfully reduce one's surtaxes, by gift or otherwise, is permissible, and of itself raises no presumption of an intention to defraud the Government. We

think the grantor has fully met the test of the regulation, unless the trustees, other than the grantor, have the power under the declaration to revest the grantor with the income or corpus, and have no power to invest any other person with such property who after such investiture must be considered as holding a substantially adverse interest to that of the grantor.

The Board held that the instrument gave to the grantor's wife and his brother or the survivor of them, during the grantor's life, full power and authority to alter the instrument by changing the beneficiary, or by changing the time when the trust fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect. Hence it held that power to revest in the grantor was vested in the wife and brother, who were persons not having a substantial adverse interest in the corpus. If the wife and brother had the power under this provision to substitute the grantor as sole or part beneficiary, they likewise would have the same power to substitute themselves, or any one else, as beneficiaries. In either event it is not necessary that such event should have transpired.

If the wife and brother had the power to name themselves, or others than the grantor, as beneficiaries, that power or right was certainly adverse to the grantor's interests. It was full and complete and not limited by reservation or failure of divestiture. Indeed, if the grantor by his instrument had in any manner reserved any interest in the property in question the other trustees would be powerless to pass a complete title. None of the cases cited by the Commissioner presented facts similar to those here. In each there was a clear reservation in the grantor, or a power or discretion in the trustees by means of which the grantor could be revested, and there was no power given any trustee, not a grantor, to substitute beneficiaries. See Kaplan v. Commissioner, 66 F. 2d 401; Rollins v. Helvering, 92 F. 2d 390; Altmaier v. Commissioner, 116 F. 2d 162; White v. Higgins, 116 F. 2d 312; Graff v. Commissioner, 117 F. 2d 247; Commissioner v. Caspersen, 119 F. 2d 94 (certiorari denied October 13, 1941); Kent v. Rothensis, 120 F. 2d 476 (certiorari denied October 13, 1941); Whiteley v. Commissioner, 120 F 2d 782 (certiorari denied October 13, 1931).

However, we are not convinced that the wife and brother of the grantor were empowered by this instrument to revest title to this property in the grantor, their co-trustee. A court of equity has power to control the administration of a trust so that it will accord with the purposes of the grantor. A discretion lodged in a trustee is rarely, if ever, to be regarded as a permit to act arbitrarily. Such discretion should be confined to the exercise of judgment not unreasonable in the light of the pur-

poses of the trust and of the circumstances in which it is sought to be exercised. The power of the court exists solely for the protection of the right of the grantor and the beneficiaries (see Rollins v. Helvering, supra), and the laws of Illinois in this respect are applicable to this case. It was conceded in argument by the Commissioner that under the Illinois law the wife and brother as trustees would have no right to substitute themselves, or either of them, as beneficiaries, yet he insists that they would have the right to substitute their co-trustee, the grantor, as the sole beneficiary. If this be true then the grantor reserved nothing in the original grant, and there would be no tax due from him under the statute. See Huffman v. Commissioner, 39 B. T. A. 880.

However, we are convinced that the wife and brother as trustees had no authority under the Illinois law to revest the property in the grantor. This would be to give them power, not only to destroy the trust but to dissipate the proceeds contrary to the purposes set forth in the declaration, and it would also furnish an opportunity by secret agreement for subsequent distribution among the trustees. Such a door should not be left open. Congress and the courts, theoretically at least, have always regarded the preservation of trust funds as a sacred obligation, and they have always and everywhere proceeded on the theory that a trust officer should not be permitted to be placed in any position where he may be "tempted above that which he is able."

Both by law and the express request of the declaration, the meaning and effect of the trust is to be determined by the laws of Illinois. See Freuler v. Helvering, 291 U. S. 35; Blair v. Commissioner, 300 U. S. 5; Morgan v. Commissioner, 309 U. S. 78. Federal authorities control only those cases where the apparent transfer of a right to income is not real, or is only temporary. See Harrison v. Schaffner, 312 U. S. 579. Where great discretion is vested in a trustee, its exercise is subject to the control of a court of chancery. Maguire v. City of Macomb, 293 Ill. 441. A very broad discretion conferred upon a trustee in the selection of beneficiaries does not constitute an unlimited discretion which the court can not control. Welch v. Caldwell, 226 Ill. 488. In Jones v. Jones, 124 Ill. 254, the court said: "It is true that the daughters are invested with a large discretion as to the manner in which they shall execute the trust * * *; but the devise being to them for the use and benefit of the children of the deceased son, the discretion vested in them will not defeat the trust. * * * The daughters, as trustees of this share, are not invested with discretion to withhold the trust fund absolutely from the cestuis que trust. The fund is not theirs, in equity, and they

can not make it so by a refusal or neglect to exercise the discretion vested in them. Their discretion as trustees of this fund is subject to the control of the courts of equity, and can not be arbitrarily exercised so as to deprive the beneficiaries of all benefit of the fund." See also Frank v. Frank, 305 Ill. 181. The same principle seems to prevail in all jurisdictions both state and federal. See Restatement of Law of Trusts, Sec. 170; Scott on Trusts, Vl. 2, Sec. 187; Lovett v. Farnham, 169 Mass. 1, 47 N. E. 246; Fleischman v. Commissioner, 40 B. T. A. 672 (acquiesced in by Commissioner); Downs v. Commissioner, 36 B. T. A. 1129.

In the last-named case the Board said that "in the construction of a trust instrument the intention of the grantor is of utmost importance." This is true, and it constitutes the pole star which should guide courts in determining the purpose of the trust and the limitation of the trustee's discretion. We are convinced that under the terms of these trusts no contingency could arise which would enable the grantor to have the income or corpus distributed to him, actually or constructively, and it is well to note that the instrument itself provides for liability of the trustees in case of fraud or mismanagement.

The Commissioner urges that the Board's ruling must be sustained under Helvering v. Clifford, 309 U. S. 331. He seems to construe that decision as meaning that the interests of beneficiaries under a trust may be disregarded for purposes of taxing the grantor if the beneficiaries are members of his family, because they would probably not assert their rights. It can not well be denied in such event that a question presents itself for a court of chancery to determine, which federal courts will not ignore. We think the ruling in the Clifford case did not go so far as to hold that mere family solidarity gave the federal courts the right to ignore the State jurisdiction to determine the rights of beneficiaries under a trust, and the extent of the trustees' discretion. The elements required to bring a taxpayer within the scope of that case are quite clearly noticed in Helvering v. Elias, 122 F. 2d. 171. They are (a) close family relationship, (b) short trust term, and (c) reservation of powers of management. See also Commissioner v. Barbour, 122 F. 2d. 165. Certiorari was denied in both of these cases. In the present case we have no short terms, nor power of management in the grantor.

We think the Board erred in holding that the petitioner John Stuart was liable under Section 166 (2) of the Act, and from what we have said we are of the opinion that he was not liable under Section 167 (a), which deals with revocable trusts, or under Section 22, which deals with gross income.

With respect to cause number 7694, the petitioner, R. Douglas Stuart, on March 25, 1929, created four separate trusts for the benefit of his four children, Robert, Anne, Margaret, and Harriet. They were all minors and their birth dates respectively were April 26, 1916, January 11, 1920, January 3, 1922, and February 3, 1928.

The provisions of these trust agreements were substantially the same except for one provision hereafter noted. Each of the trusts comprised 1,500 shares of common stock of the Quaker Oats Company, of which the petitioner was first vice president. The trustees were the petitioner, his wife, Harriet McClure Stuart, and his brother, John Stuart.

The trust agreements provided that the trustees should pay to the child designated as the beneficiary of the particular trust agreement or apply to such child's education, support, and maintenance, so much of the net income as the trustees should deem advisable, and that the trustees should add the unexpended portion of the net income to the principal of the particular trust. When the beneficiary became 30 years of age (25 years of age in the case of Robert) the trustees were to pay over to such beneficiary one-half of the principal of the trust. Thereafter the trustees were to pay over to the beneficiary the net income from the remaining one-half of the principal of the trust until such beneficiary became 35 years of age (30 years of age in the case of Robert) when the trustees were to pay over to the beneficiary the remaining one-half of the principal of the trust.

In the event of the death of a child of the petitioner before receiving all of the principal of his trust, the trustees were to pay over the principal of the trust to the child's issue then living, or, if there were no such issue, then to the living issue of the petitioner, or, if there were no such issue then living, then in equal shares to Princeton University and the Presbyterian Hospital of Chicago. The trustees were given the usual broad powers of management and administration. There was a spendthrift clause, a clause exonerating the trustees from liability except for fraud and willful mismanagement, a provision appointing a trust company as a co-trustee or sole trustee if two of the trustees should resign, and a provision that the trust should be governed by the laws of the State of Illinois.

Paragraphs eight and nine of these trusts are identical with paragraphs eight and nine of the John Stuart trust, except as to the names of the donor and the other two trustees.

On August 2, 1935, each of these trust agreements was amended by the two trustees, Harriet McClure Stuart and John Stuart, by eliminating paragraph eight, and changing paragraph nine

so as to make the indenture and all of its provisions irrevocable and not subject to alteration, change, or amendment.

In all the years from the creation of the trusts to and including 1935, the entire net income of these trusts was accumulated and added to the principal except that in 1934 there was distributed to Robert $1,291.50, and in 1935 there was distributed to him $1,882.50 of the income. At the time of the creation of the four trusts, the taxpayer's net worth was approximately $3,000,000, and the property which he transferred to the trusts had a value of approximately $600,000.

Bearing on the question of motive, the petitioner had discussed the matter with his brother, John Stuart, prior to the creation of the trusts by his brother, John, in 1930, and it seemed to this petitioner that John's was a wise procedure. When the trusts were created, petitioner's children were all minors. He said: "Times were very uncertain and I felt that while I had an opportunity to provide for them in the form of a trust, that was the wise thing to do." No changes have been made in the beneficiaries of the trusts nor in the property that went into them.

The Commissioner determined that the entire net income of the trusts for 1934, and from January 1 to August 2, 1935, was taxable to the petitioner under section 166 (2) of the Act, and the Board affirmed that determination. The Board did not deem it necessary to consider the applicability of sections 167 (a) and 22 (a) of the Act.

The same questions are presented in this case as were presented in the former case. The only factual difference with respect to the trusts of the two brothers is that during the years 1934 and 1935 John's children were all of age, and the children of Douglas were all minors. It is to be noted with respect to the trusts of the daughters of Douglas, that the entire income involved was accumulated and added to the principal for later distribution to them at the specified ages, whereas with respect to John's daughters substantially all the income was distributed currently to them. With respect to their sons, it is further to be noted that relatively small sums were paid to them, and the balance was accumulated and added to the principal.

What we have said in the case of the trusts for John's children, with respect to the applicability of sections 166 (2) and 167 (a) (2), need not be repeated. We hold that those two sections are not here applicable.

The remaining question is whether section 22 (a) is applicable, because of the minority of his children under Douglas v. Willcuts, 296 U. S. 1. We think it is, to a limited extent, because in each trust here involved the indenture provides for the use of the income for the education, support and maintenance

of the minor children, and if it was so used, such applications, under the Willcuts case, must be considered as having been used for the grantor's benefit in the discharge of his obligation to his minor children. Such obligation is, of course, limited to a reasonable allowance consistent with the taxpayer's station in life, and the minor's welfare. Under the ruling of Commissioner v. Grosvenor, 85 F. 2d 2, the burden was on the grantor, if he were to escape taxation on the trust income, to prove that the distributed income was not in fact used for those purposes. We think that burden has been met with respect to all of the income of these trusts, with the exception of $1,391.50 which was paid to Robert in 1934, and $1,882.50 which was paid to him in 1935. All of the income received, aside from these two sums, was admitted to have been credited to principal, and this fact would seem to eliminate any possibility that it was or could ever be applied to the support or education of the minor children.

The Commissioner relies on Whitely v. Commissioner, 120 F. 2d 782 (certiorari denied October 13, 1941), as holding that the income from the trusts must be taxed against the income of the taxpayer because it was available and could have been used to discharge his obligations to his minor children, although in fact it never was. We are not convinced that the Whiteley case goes that far, although the precise language referred to is found in that opinion if it be read separately from its context. In that case, and other seemingly analogous cases, there were clear reservations of rights to the grantor which might well be considered as bringing the trusts within the provisions of section 167 as well as section 22 (a). In deed, the opinion in the Whiteley case informs us, with respect to the childrens' trusts, that the respondent there relied upon sections 167 (a) (1) (2) (3) (b), and the court quotes them as the "applicable statute," and adds that "an examination of a line of Supreme Court decisions under section 22 (a), the gross income section of the statute seems to leave little or no room to doubt the correctness of the Board's conclusion * * *." It should be further noted that that court also found that the settlor could have received the entire income and applied it to the support of his minor children, which he did not choose to do, and it further found that the settlor controlled the use of the money, neither of which rights did the settlor reserve in either of these trusts.

The burden being on this taxpayer to prove that the distributed income was not in fact used for the education and support of his minor son, we think that the amount of such income which was actually received by him, or for him, must be considered as being income of the grantor, because there is no evidence to the contrary.

In cause number 7695 the decision of the Board is reversed. In cause number 7696 the Board's decision is affirmed as to the income which was distributed to Robert Stuart during the years 1934 and 1935. The decision is reversed as to those amounts of income which were not distributed to the beneficiaries but were credited to the corpora during the years in question. The causes are ordered remanded for further proceedings not inconsistent with this opinion.

And, on the same day, to wit: On the nineteenth day of December 1941 the following further proceedings were had and entered of record, to wit:

Friday, December 19, 1941

Court met pursuant to adjournment.

Before: Hon. William M. Sparks, Circuit Judge; Hon. J. Earl Major, Circuit Judge; Hon. Sherman Minton, Circuit Judge.

7696

R. DOUGLAS STUART, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board of Tax Appeals

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the United States Board of Tax Appeals entered in this cause on January 14, 1941, be, and the same is hereby affirmed as to the income which was distributed to Robert Stuart during the years 1934 and 1935, and reversed as to those amounts of income which were not distributed to the beneficiaries but were credited to the corpora during the years in question, and that this cause be, and it is hereby, remanded to the said United States Board of Tax Appeals for further proceedings not inconsistent with the opinion of this Court filed herein this day.

United States Circuit Court of Appeals for the Seventh Circuit

I, Kenneth J. Garrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that

the foregoing typewritten and printed pages contain a true copy of the opinion filed on the nineteenth day of December 1941 and the judgment entered on the nineteenth day of December 1941 in the following entitled cause: Cause No. 7696, R. Douglas Stuart, petitioner, vs. Commissioner of Internal Revenue, respondent, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this thirteenth day of February, A. D. 1942.

[SEAL]

KENNETH J. CARRICK,
Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.

U. S. GOVERNMENT PRINTING OFFICE: 1942

SUPREME COURT OF THE UNITED STATES

Order allowing certiorari

Filed April 27, 1942

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted, and the case is placed on the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

46863—42 U. S. GOVERNMENT PRINTING OFFICE, 1942

FILE COPY

No. ~~1055~~ 49

In the Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

R. DOUGLAS STUART

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

INDEX

CITATIONS

449524—42

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

R. DOUGLAS STUART

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit entered in the above case on December 19, 1941, reversing in part the decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 26–37) is unreported. The opinion of the Circuit Court of Appeals (R. 46–57) is not yet officially reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 19, 1941 (R. 57). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer executed four trusts, one for each of his four children, who were minors during the taxable years here involved, naming himself, his wife, and his brother as trustees. The corpus of each trust consisted of shares of stock in a corporation of which the taxpayer was first vice president and the taxpayer's brother was president. Until the beneficiary of each trust reached the age of thirty (twenty-five in the case of one child), so much of the net income was to be distributed to him or applied for his education, maintenance, and support as the trustees deemed advisable, the balance to be accumulated. When the beneficiary of each trust attained the age of thirty (twenty-five in the case of one child), one-half of the corpus was to be paid over to him. The net income from the remaining portion of the trust fund was to be paid to him during the next five years, at which time he was to receive the balance of the corpus. The taxpayer reserved the right to withdraw any part of the corpus upon substitution of other property of equal value. During the life of the taxpayer his wife and brother had

power to alter, change, or amend the trusts in any respect. Was the income from the trusts created by the taxpayer taxable to him under Sections 166 (2), 167 (a), or 22 (a) of the Revenue Act of 1934?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix to the Government's petition for certiorari in *Helvering* v. *John Stuart*, which is being filed herewith.

STATEMENT

The facts, taken from the findings of fact by the Board (R. 27) and the stipulation filed by the parties (R. 13), may be summarized as follows:

The taxpayer and his wife, Harriet McClure Stuart, have four children: Robert, born April 26, 1916; Anne, born January 11, 1920; Margaret, born January 3, 1922; and Harriet, born February 3, 1928 (R. 27). On March 25, 1932, the taxpayer executed four trust indentures by which he created trusts for the benefit of each of his four children (R. 27). The provisions of each of the trust indentures were substantially the same (R. 13, 27). The taxpayer, his wife, and his brother, John Stuart, were named as trustees of each trust. The corpus of each trust consisted of 1,500 shares of the common stock of the Quaker Oats Company, of which the taxpayer was first vice president (R. 27). Each indenture provided that until the child desig-

nated as the beneficiary therein became thirty years of age (twenty-five years of age in the case of one child), the trustees were to pay over to the beneficiary so much of the net income or apply so much of the net income for his education, support, and maintenance "as to them shall seem advisable, and in such manner as to them shall seem best, and free from control of any guardian" (R. 16, 27). The unexpended portion of the net income was to be added to the principal of the trust (R. 16, 27). When the beneficiary reached the age of thirty (twenty-five in the case of one child), one-half of the principal was to be paid over to him. Thereafter the trustees were to pay over to the beneficiary the net income from the remaining portion of the trust fund during the next five years, at which time the balance of the principal was to be paid over to the beneficiary (R. 16, 27). In the event of the death of the beneficiary before receiving all of the principal of the trust, the principal was to be paid to the beneficiary's surviving children, or, if the beneficiary left no surviving children, then the principal was to be paid over to the issue then surviving of the taxpayer, with remainders over in the event of default (R. 16–17, 27). Each trust indenture contained a clause providing that the trustees were not to incur any liability "except such as may be due to * * * actual fraud or willful mismanagement" (R. 18, 28). Each indenture contained a "spendthrift" clause prohibiting anticipation by the beneficiary (R. 17). Articles

Eighth and Ninth of each indenture provided as follows (R. 28–29):

> Eighth. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and delivering to the Trustees other property satisfactory to them of a market value at least equal to that of the property so withdrawn.
>
> Ninth. During the life of the Donor, the said Harriet McClure Stuart and the said John Stuart, or the survivor of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect.

During the period from March 25, 1932, to August 2, 1935, no changes were made in the beneficiaries of the four trusts or in the prop-

erty held by the trusts (R. 29). The total net income of the four trusts was $37,162.91 in 1934 (R. 29). The total net income of the trusts for 1935 was $39,217.03, of which amount $25,831.15 was received by the trustees during the period from January 1 to August 2, 1935 (R. 29). The income from each of the trusts is set forth in the following table (R. 29):

Trust for—	1934	1935
Robert	$9,307.91	$9,866.30
Anne	9,266.29	9,767.46
Margaret	9,291.81	9,782.17
Harriet	9,296.90	9,799.20

None of the income was distributed to any of the beneficiaries in 1934 or 1935, except that in 1934, $1,391.50 and in 1935, $1,882.50 of the net income from the trust for Robert was distributed to him (R. 29). At the time of the creation of the four trusts, the taxpayer's net worth was approximately $3,000,000 and the property which he transferred to the trusts had a value of approximately $600,000 (R. 30).

On August 2, 1935, Harriet McClure Stuart, taxpayer's wife, and John Stuart, taxpayer's brother, executed an amendment to each of the four trust indentures, canceling paragraph eighth, and changing paragraph ninth to read as follows: "Ninth. This Indenture and all the pro-

visions thereof are irrevocable and not subject to alteration, change or amendment" (R. 29).

Exclusive of the income of the four trusts the taxpayer had net income in 1934 of $117,153.17, and in 1935 of $175,794.47 (R. 29). The Commissioner determined that the net income of the four trusts for 1934 and the net income of the four trusts from January 1, 1935, to August 2, 1935, was taxable to the taxpayer and determined a deficiency accordingly. The deficiency determined by the Commissioner included some other adjustments (R. 9) which were not contested and are not here in issue. The Board of Tax Appeals sustained the determination of the Commissioner, holding that the income from the trusts was taxable to the taxpayer under Section 166 (2) of the Revenue Act of 1934 (R. 26–37). Before the Circuit Court of Appeals the Government contended that the Board's decision was sustainable under Sections 167 and 22 (a) as well as under Section 166. The court held that so much of the income which was distributed to Robert Stuart during the years 1934 and 1935 was presumably used in discharge of the taxpayer's obligation to support his minor child and was therefore taxable to him. With respect to the remainder of the income the court reversed the Board's decision (R. 57).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the income from the trusts was not taxable to the taxpayer under Section 166 of the Revenue Act of 1934.

2. In holding that the income from the trusts was not taxable to the taxpayer under Section 167 of the Revenue Act of 1934.

3. In holding that only so much of the income from the trust for Robert Stuart as was distributed to him was taxable to the taxpayer under Section 22 (a) of the Revenue Act of 1934.

REASONS FOR GRANTING THE WRIT

This case is a companion case to *Helvering* v. *John Stuart,* in which a petition for certiorari is being filed herewith. The reasons advanced in the petition in the *John Stuart* case for the granting of the writ are equally applicable here.

In addition, the decision below is in substantial conflict with *Whiteley* v. *Commissioner,* 120 F. (2d) 782 (C. C. A. 3d), certiorari denied, October 13, 1941, No. 516, present Term, to the extent that the trust income was available but not used for the discharge of the grantor's obligation to support his minor children.[1] In the *Whiteley*

[1] Cf. *Helvering* v. *Stokes,* 296 U. S. 551; *Helvering* v. *Schweitzer,* 296 U. S. 551; *Douglas* v. *Willcuts,* 296 U. S. 1; *Helvering* v. *Blumenthal,* 296 U. S. 552; *Helvering* v. *Coxey,* 297 U. S. 694.

case the court held that the availability of the income for the purpose of discharging an obligation to support was sufficient to render it taxable to the grantor. In the instant case the court below has held to the contrary. It is true that in the *Whiteley* case the use of the income for support of the grantor's child was within the sole control of the grantor, whereas in the instant case that control was shared by the grantor with his wife and brother. But under the Board's decision the grantor's wife and brother were persons amenable to his wishes with respect to the administration of the trusts, and the case is therefore essentially similar to the *Whiteley* case.

CONCLUSION

It is respectfully submitted that this petition should be granted.

CHARLES FAHY,
Solicitor General.

MARCH 1942.

U. S. GOVERNMENT PRINTING OFFICE: 1942

FILE COPY

No. 39

In the Supreme Court of the United States

OCTOBER TERM, 1942

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

R. DOUGLAS STUART

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

INDEX

CITATIONS

486009—42——1

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 49

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

R. DOUGLAS STUART

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 26–37) is reported in 42 B. T. A. 1421. The opinion of the Circuit Court of Appeals (R. 46–57) is reported in 124 F. (2d) 772.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 19, 1941. (R. 57.) The petition for a writ of certiorari was filed March 19, 1942, and was granted April 27, 1942. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer established four trusts, one for the support and benefit of each of his four children, all of whom were minors during the taxable periods here involved, naming himself, his wife, and his brother as trustees. The corpus of each trust consisted of shares of stock in a corporation of which the taxpayer was first vice president and his brother was president. The grantor reserved the right to direct the trustees with respect to sales and reinvestments of trust property. During the grantor's life, his wife and brother were empowered to change the beneficiaries of the trusts and to amend the indentures in any respect. Is the grantor accountable under Sections 166, 167, or 22 (a) of the Revenue Act of 1934 for the income of these trusts?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix to the Commissioner's brief in *Helvering* v. *John Stuart,* No. 48, present Term, a companion case to be argued immediately preceding the instant one.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 27–30) may be summarized as follows:

Taxpayer and his wife, Harriet McClure Stuart, have four children: Robert, born April 26, 1916; Anne, born January 11, 1920; Margaret, born

January 3, 1922; and Harriet, born February 3, 1928 (R. 27).

On March 25, 1932, taxpayer created four separate trusts, one for the benefit of each of his four children. In the trust indentures taxpayer named himself, his wife, and his brother, John Stuart, as the trustees of each trust. To the trustees of each trust taxpayer transferred 1,500 shares of the common stock of the Quaker Oats Company of which he was first vice president (R. 27).

The provisions of each of the four trust indentures were substantially the same. Until the child designated as the beneficiary of the particular trust became 30 years of age (25 years of age in the case of the trust for taxpayer's son), the trustees were to pay over to the beneficiary, or were to apply for the beneficiary's education, support, and maintenance, so much of the net income of the trust as seemed advisable to the trustees, and were to add the unexpended portion of the net income of the trust to the principal of the trust. When the beneficiary became 30 years of age (25 years of age in the case of the trust for taxpayer's son), the trustees were to pay over to the beneficiary one-half of the principal of the trust. Thereafter, the trustees were to pay over to the beneficiary the net income from the remaining one-half of the principal of the trust until the beneficiary became 35 years of age (30 years of age in the case of the trust for taxpay-

er's son), when the trustees were to pay over to the beneficiary the remaining one-half of the principal of the trust (R. 27).

In the event of the beneficiary's death before receiving all of the principal of the trust, the trustees were to pay over the remaining principal to the beneficiary's children; or, if the beneficiary left no children surviving, to taxpayer's issue then surviving; or, if the beneficiary left no children surviving and there were then surviving no issue of taxpayer, to Princeton University and the Presbyterian Hospital of the city of Chicago in equal shares (R. 27).

The trustees were empowered to collect all income; to sell any of the securities held in trust; to invest the proceeds from the sale of securities and the net income added to trust principal in income producing property or securities, real or personal, without being restricted to investments as fixed by the statutes of Illinois; to execute all necessary assignments and other instruments; to exercise the voting power upon all shares of stock held in trust; to exercise every power and do every act and thing in respect of any shares of stocks and bonds which they could or might do if they were absolute owners thereof; to unite with others in carrying out any plan for the reorganization of any corporation the securities of which were held in trust; to exchange the securities of any corporation for other corporate securities;

to assent to the consolidation or merger of any corporation; to pay assessments and expenses for the protection of the interest of the trust in the securities of any corporation; and to employ agents and attorneys (R. 28).

Stock dividends, liquidating dividends, and proceeds from the sale of any part of the trust fund, including profits, were to constitute principal (R. 28).

Each trust indenture contained a clause providing that the trustees were not to incur any liability except such as might be due to actual fraud or willful mismanagement, and a clause providing that any person dealing with the trustees was not to be required to see to the application of any money paid to the trustees (R. 28).

Paragraphs eighth and ninth of each trust indenture provided as follows (R. 28–29):

> Eighth. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and delivering to the Trustees other property satisfactory to them of a market value at least equal to that of the property so withdrawn.

> Ninth. During the life of the Donor, the said Harriet McClure Stuart and the said John Stuart, or the survivor of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect.

On August 2, 1935, taxpayer's wife and brother executed an amendment to each of the four trust indentures, canceling paragraph eighth and changing paragraph ninth to read as follows (R. 29):

> Ninth. This Indenture and all the provisions thereof are irrevocable and not subject to alteration, change or amendment.

During the period from March 25, 1932, to August 2, 1935, no changes were made in the beneficiaries of the four trusts or in the property held by the trusts. (R. 29.)

On the fiduciary income tax returns filed by the trustees of the four trusts for the years 1934 and 1935 the net income of each of the trusts was reported as follows (R. 29):

Trust for—	1934	1935
Rober	$9,207.91	$9,859.20
Anne	9,208.23	9,787.46
Margaret	9,201.81	9,782,17
Harriet	9,226.20	9,788.20

In 1934 and 1935 the entire net income of the trusts for Anne, Margaret and Harriet was added to the principal of the respective trusts. In 1934 and 1935 $1,391.50 and $1,882.50 of the net income of the trust for Robert was distributed to him and the balance of the net income was added to the principal of the trust (R. 29).

In 1934 the total net income of the four trusts was $37,162.91, and in 1935 the total net income of the four trusts was $39,217.03, of which amount $25,831.15 was received by the trustees during the period from January 1 to August 2, 1935 (R. 29).

Taxpayer's net income (not including any income of the four trusts) was $117,153.17 in 1934 and $175,794.47 in 1935. At the time of the creation of the four trusts, taxpayer's net worth was approximately $3,000,000 and the property which he transferred to the trusts had a value of approximately $600,000 (R. 29–30).

In determining the deficiencies for 1934 and 1935, the Commissioner included in the taxpayer's income the net income of each of the trusts for 1934 and the period from January 1, 1935, to August 2, 1935. The Board of Tax Appeals sustained the Commissioner's action but the court below reversed the decision of the Board as to all of the trust income except the amounts distributed to Robert Stuart.

This is a companion case to *Helvering* v. *John Stuart, supra,* where, as more fully shown by the

record therein, to which reference is here made, the grantor established three trusts, one for each of his three children, naming himself, his wife, and his brother (this grantor) as trustees. The corpus of each trust consisted of shares of stock in the Quaker Oats Company of which both brothers were high officers. The trusts contained substantially the same provisions as the instant ones and also empowered the grantor's wife and brother to make any changes in those provisions. On August 3, 1935, the wife and brother relinquished that power.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the trust income was not taxable to the grantor under Sections 166 or 167 of the Revenue Act of 1934.

(2) In holding that only the amounts of income distributed to Robert Stuart were taxable to the grantor under Section 22 (a) of the Revenue Act of 1934 and in not holding that all of the trust income here involved was taxable to the grantor under that section.

(3) In reversing the decision of the Board of Tax Appeals.

ARGUMENT

I

THE ENTIRE NET INCOME OF THE TRUSTS IS TAXABLE TO THE GRANTOR UNDER SECTIONS 166, 167 AND 22 (A) OF THE REVENUE ACT OF 1934

This case presents the same questions as those in the *John Stuart* case, *supra,* and reference is here made to our brief in that case which sets forth in full the arguments in support of the Commissioner's position both there and here.

II

IN ANY EVENT, THE UNDISTRIBUTED TRUST INCOME IS TAXABLE TO THE GRANTOR BECAUSE IT COULD HAVE BEEN USED FOR THE SUPPORT OF HIS MINOR CHILDREN

Since all of the taxpayer's children were minors during the taxable years (R. 14, 27), a further question, not presented in the John Stuart case, arises here. By Paragraph Fourth of each trust indenture, the grantor, his wife and his brother, as trustees, were empowered to pay over to the child-beneficiary or apply so much of the net income for his education, support and maintenance as they should deem advisable. The question is whether the grantor is taxable upon trust income which was available for support of the children even though it was not so applied. The court below answered this question in the negative, taking

the view that the grantor was accountable only for the amounts of income actually distributed to one of the children, Robert. We submit that in the circumstances of this case the grantor is taxable upon all of the trust income which could have been used for the education, support and maintenance of the children, under the authority of both Section 167 and Section 22 (a).

There is no question that the grantor was legally obligated to support his minor children during the taxable years, and, indeed, the court below so conceded in holding him taxable under *Douglas* v. *Willcuts*, 296 U. S. 1, on the income distributed to Robert. See also *Helvering* v. *Schweitzer*, 296 U. S. 551; *Helvering* v. *Stokes*, 296 U. S. 551; *Helvering* v. *Coxey*, 297 U. S. 694; *Commissioner* v. *Grosvenor*, 85 F. (2d) 2 (C. C. A. 2). Those cases all hold and it is now settled that the grantor of a trust is taxable upon income therefrom which is applied pursuant to the trust terms in satisfaction of his legal obligations. *Helvering* v. *Fitch*, 309 U. S. 149; *Helvering* v. *Leonard*, 310 U. S. 80.

The basis on which the grantor is taxable on income of a trust used to satisfy his legal obligations was explained as follows in *Douglas* v. *Willcuts*, 296 U. S. 1, 9:

> We have held that income was received by a taxpayer, when, pursuant to a contract, a debt or other obligation was discharged

> by another for his benefit. The transaction was regarded as being the same in substance as if the money had been paid to the taxpayer and he had transmitted it to his creditor * * *. The creation of a trust by the taxpayer as the channel for the application of the income to the discharge of his obligation leaves the nature of the transaction unaltered. * * * In the present case, the net income of the trust fund, which was paid to the wife under the decree, stands substantially on the same footing as though he had received the income personally and had been required by the decree to make the payment directly.

Since one whose legal obligation is paid by a distribution of income from a trust is treated for income-tax purposes as having received that income himself, it follows that one whose legal obligation could have been paid by the use of income of a trust must be treated for income-tax purposes as if that income could have been distributed to him directly.

Consequently, the taxpayer herein was taxable under Section 167 (a) (2), which taxes the grantor "Where any part of the income of a trust * * * may in the discretion, etc. * * * be distributed to the grantor" because the taxpayer could, jointly with two other trustees not having a substantial adverse interest, have distributed the entire income of the trusts for the support and maintenance of his minor children. As we have seen,

such a distribution would for tax purposes have been tantamount to a distribution directly to the taxpayer.

In our brief in *Helvering* v. *John Stuart,* No. 48, we have shown that the grantor's wife and brother did not have a substantial adverse interest in the trust. That showing is applicable here and justifies the conclusion that the wife and brother as trustees did not have a substantial adverse interest to the use of the income for the support and maintenance of the grantor's minor children. Moreover, it is difficult to imagine that a mother would consider herself adverse to a distribution of money for support of her children. Cf. *Commissioner* v. *Caspersen,* 119 F. (2d) 94 (C. C. A. 3), certiorari denied, 314 U. S. 643. And it is also difficult to imagine the brother's opposing such a distribution, particularly in view of the trusts established by that brother in which the grantor herein was trustee and donee of a general power. Thus the wife and brother are wholly without an interest adverse to the use of the trust income for the support and maintenance of the minor children, and the conditions of the statute upon which taxability to the grantor depends are fully met.

The taxpayer also is taxable under section 22 (a) for the reasons set forth in *Whiteley* v. *Commissioner,* 120 F. (2d) 782 (C. C. A. 3), certiorari denied, 314 U. S. 657. The power of the

grantor to use the income so as to satisfy his own legal obligations, coupled with the other controls he retained over the income and corpus of the family trust, justifies taxing him as the owner of the income who has merely made a gift of it. Compare *Helvering* v. *Horst*, 311 U. S. 112.

In our brief in *Hormel* v. *Helvering*, 312 U. S. 552, we raised a similar point [1] which was not considered by the Court in its opinion, for it disposed of the case upon the broader ground that the grantor remained in substance the owner of the trust properties under the rule in *Helvering* v. *Clifford*, 309 U. S. 331.

CONCLUSION

The judgment of the court below should be reversed.

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[1] Although there is a ruling (G. C. M. 18972, 1937–2 Cum. Bull. 231, 233) which appears to be contrary to our position, that ruling seems out of harmony with Article 167–1 of Regulations 86 which both as originally adopted and as amended (see Appendix to Commissioner's brief in *John Stuart* case) is in accord with our interpretation of the law. That ruling was precipitated by *Black* v. *Commissioner*, 36 B. T. A. 346, but since the decisions in *Pyeatt* v. *Commissioner*, 39 B. T. A. 774, and *Whiteley* v. *Commissioner*, *supra*, affirming 42 B. T. A. 402, as well as certain unpublished decisions of the Board of Tax Appeals also pointing the other way, the Treasury has been doubtful of the validity of that ruling and now wishes the Court to consider the issue in order that it may be authoritatively settled.

Respectfully submitted.

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OCTOBER 1942.

U. S. GOVERNMENT PRINTING OFFICE: 1942

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. ~~1055~~ 49

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

R. DOUGLAS STUART,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

GEORGE I. HAIGHT,
WILLIAM D. MCKENZIE,
HERBERT POPE,
Counsel for Respondent.

April 7, 1942.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 1055.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

R. DOUGLAS STUART,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

This case is similar to *Helvering* v. *John Stuart* and what we said in our brief in that case applies equally here.

The trusts involved in this case were created by the respondent two years after his brother, John Stuart, had created the trusts involved in that case. The respondent desired to provide for his children and naturally followed, except in some particulars, the form of trust which his brother had used. Because of the similarity and in spite of the fact that the trusts were not created at or near the same time, the Board of Tax Appeals thought that each grantor controlled his brother and could by mutual agreement take back the principal of his own trusts. This would involve two breaches of trust, one in each case, since, as the Court of Appeals pointed out, neither grantor could

be given back any property in the trusts created by him without a breach of trust by his brother and his wife.

Surely neither section 166 nor any other income tax provision will be applied by this Court on the assumption that by means of a fraudulent scheme for reciprocal breaches of trust the grantors might recover the principal of trusts they had created for the benefit of others.

The only decision expressly mentioned by Petitioner in his petition differs from the present case in that it involved sole control expressly reserved by the grantor.

Respectfully submitted,

GEORGE I. HAIGHT,
WILLIAM D. MCKENZIE,
HERBERT POPE,
Counsel for Respondent.

April 7, 1942.

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 49

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

R. DOUGLAS STUART,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT.

HERBERT POPE,
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Counsel for Respondent.

WILLIAM D. MCKENZIE,
Of Counsel.

INDEX.

IN THE

Supreme Court of the United States

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No. 49.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

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vs.

R. DOUGLAS STUART,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT.

Argument.

The facts in this case differ very slightly from the facts in *Helvering* v. *John Stuart*, No. 48, to be presented to this Court at the same time as this case, and the argument in our brief in that case applies in this case, so that it is unnecessary to repeat here the contentions made in that brief. We will limit our argument here to a single question not raised by the facts in the other case.

The only question in this case which is not in the John Stuart case is whether, in view of the minority of the grantor's children, the income of the trusts is taxable to him. In other words, was the income which was added to principal for the benefit of the grantor's children in reality his own?

Where income is *actually* used for the grantor's benefit it has been held by this Court to be taxable to him. But where the income *might have been* used for the support or education of minor children of the grantor but was not actually so used, such income is not taxable to the grantor.

Commissioner v. *Grosvenor*, 85 F. (2d) 2.

Black v. *Commissioner*, 36 B. T. A. 346 (acquiesced in by Commissioner, Cumulative Internal Revenue Bulletin, 1937-2, p. 3).

Tiernan v. *Commissioner*, 37 B. T. A. 1048 (acquiesced in by Commissioner, Cumulative Internal Revenue Bulletin 1939-1, p. 35).

Chandler v. *Commissioner*, 41 B. T. A. 165, 178.

Wolcott v. *Commissioner*, 42 B. T. A. 1151 (acquiesced in by Commissioner, Cumulative Internal Revenue Bulletin, 1941-1, p. 11).

Examining the facts in the present case in the light of these decisions, we find that of the income here involved ($37,162.91 for 1934 and $25,831.15 for 1935) only $1,391.50 in 1934 and $1,882.50 in 1935 were distributed to a minor beneficiary. The rest was accumulated and added to principal. Even economically speaking, none of the income thus accumulated was the petitioner's income.

The contention of the government that possibility rather than actuality governs was rejected by the Circuit Court of Appeals for the Sixth Circuit in *Suhr* v. *Commissioner*, 126 F. (2d) 283, 286, citing *Commissioner* v. *Grosvenor*, *supra*, and the decision of the Circuit Court of Appeals in the present case.

Counsel admit, (Brief, 13) that under the Commissioner's own formal ruling following the decision in *Black* v. *Commissioner, supra,* this accumulated income is not taxable to the grantor merely because the trustees might have used it for the support of the children. Counsel contend, however (Brief, 12, 13) that this income is taxable under section 22 (a) and *Whiteley* v. *Commissioner,* 120 F. (2d) 782, and thus infer that there is a conflict between the decision in the present case and the decision of the Circuit Court of Appeals for the Third Circuit in that case.

The court below, however, correctly distinguished the *Whiteley* case on the ground that

> "there were clear reservations of rights to the grantor which might well be considered as bringing the trusts within the provisions of section 167 as well as 22 (a). * * * It should be further noted that that court also found that the settlor could have received the entire income and applied it to the support of his minor children, which he did not choose to do, and it further found that the settlor controlled the use of the money, neither of which rights did the settlor reserve in either of these trusts" (R. 56).

The court below held that the amounts actually distributed to the grantor's son might have been used by him for his support or education and were taxable to the grantor because no proof was made as to the use of those amounts, but that the amounts added to principal of the four trusts could not then be used for such purposes, and hence were not taxable to him.

In the *Whiteley* case the grantor was specifically given the right to obtain and use income of the trusts for the support of his minor children, while in the present case the three trustees, who represented the beneficiaries, determined whether and to what extent income was to be paid to a minor or applied for his support or accumulated and added to principal. In the *Whiteley* case the grantor, who

was not the trustee, had sole control of the income during the minority of his children and could act entirely in his own interest.

We submit that the judgment should be affirmed.

HERBERT POPE,
GEORGE I. HAIGHT,
BENJAMIN M. PRICE,
Counsel for Respondent.

WILLIAM D. MCKENZIE,
Of Counsel.
October 16, 1942.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 49

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

R. DOUGLAS STUART,

Respondent.

PETITION BY RESPONDENT FOR REHEARING.

HERBERT POPE,
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 49

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

R. DOUGLAS STUART,

Respondent.

PETITION BY RESPONDENT FOR REHEARING.

We respectfully petition this Court for a rehearing in this case, because we believe that the decision of this Court fails to consider questions which involve not only the income tax but the gift tax as well. We believe also that we are especially entitled to make this request because we were deprived upon the oral argument of the opportunity to use the half hour which was allotted to us for the presentation of some of the points which we now make.

The trustees under each trust in question have authority, as this Court states on page 11 of its opinion, to devote so much of the net income for the minor beneficiary as "to

them shall seem advisable" to the "education, support and maintenance" of the minor. This necessarily imposed a duty upon the trustees to see that some provision was made each year for the purpose so expressed. If this purpose was not satisfied in some other way, then there was an obligation on the trustees to use income of the trust funds for that purpose. And in any event it was the duty of the trustees to add to the principal of the trusts any amount not used to discharge the grantor's obligation to his minor children.

The record in this case discloses that in the case of three of the four minor children, all of the income of the trusts was retained by the trustees for the years here in question, and in the case of the other child most of it was. This means, unless the trustees failed to discharge their duty, that the obligation of the father, the grantor, was discharged in three instances in some other way than by the use of trust income. It also means that the income of the four trusts in this period not only might be more but was in fact more than was required to discharge the obligation of the grantor to support his minor children.

This Court decides, therefore, that even though none of the income is used to discharge the grantor's obligation, still it should be taxed to the grantor because of "the possibility of the use of the income to relieve the grantor." It follows, of course, that, while a grantor in such a case may be taxed on all of the income which is already given irrevocably to minors, there could be no gift tax on such income because of the possibility that all of it might be used to discharge the obligation of the grantor. This would be true of a trust created after the gift tax became effective. A parent may thus make very substantial gifts to his minor children without any gift tax and yet pay no greater income tax than he would pay if no gifts had been made. In this case something over $35,000 was accumu-

lated in one year, and other grantors, under the decision of this Court, might be able to increase that amount substantially without a gift tax.

These are some of the considerations which undoubtedly influenced the Board of Tax Appeals in the cases in which it has held that accumulated income is not taxable to the grantor merely because the trustees might have used it for the support of minors. The Commissioner's own ruling (G. C. M. 18972, 1937—2 Cum. Bull. 231, 233) adopted this view, and, as stated in our brief, he also acquiesced in several Board decisions to the same effect.

In view of the many complications involved in this particular question, we submit that the repeated action of the Commissioner should be regarded as a determination peculiarly within his jurisdiction, and that a change in his ruling should not be permitted after many persons undoubtedly have relied upon the good faith of his determination.

At some time, on account of the gift tax, it will be necessary to distinguish between funds reasonably required to discharge a father's obligation to support and educate his minor children and funds over and above that amount also given to them. In the meantime, it must be clear that funds that are not used in discharge of an obligation but are otherwise disposed of cannot be claimed by the father to be free from gift tax if they are given to or transferred for the benefit of his children. If that is true with reference to the gift tax it must also be true with reference to the income tax. In this case we are concerned only with funds that we know were not used to discharge the grantor's obligation to his minor children. The fact that they might have been so used should make no difference in the application either of the gift tax or the income tax. We are concerned in this case only with the years 1934 and

1935, and we know that the income here in question for those years was not used to discharge any obligation of the grantor in those years.

No doubt the Commissioner, in determining the gift tax in such cases, will take into consideration the law of the states that may be involved. In Illinois this obligation, under some circumstances, may cease as to boys as well as girls when they reach the age of 18. In any event, the trustees in this case were required necessarily to determine that the law of Illinois was complied with so far at least as any legal obligation was concerned. The oldest child, Robert, reached 18 in April, 1934 (Rec. 14), the first year in question in this case, and any criminal liability for non-support on the part of the father ceased at that time. All further obligation beyond the mere duty to support depends, under the law of Illinois, upon the facts and circumstances in each case. It was the duty of the trustees in the case of each minor in this case to determine each year that these obligations were discharged. It is not claimed that the law of Illinois which creates the obligation was not satisfied. The claim is that all of the income provided for that purpose and others must, regardless of facts and circumstances, be taxed to the grantor, although it is clear that any income retained by the trustees in the years 1934 and 1935 was not required and need no longer be made available by them for the discharge of any such legal obligation. Such income became a part of the principal of the trusts. The possibilty of the use, therefore, of this particular income to relieve the grantor was terminated and the ground upon which this Court bases its decision, we submit, was removed.

The opinion of this Court does not disclose that it has given consideration to the questions we have now raised, and we therefore respectfully ask for a rehearing in this case. If this Court should then find it necessary to con-

sider questions raised in the John Stuart case, No. 48, we ask that it consider Point II in our Petition for Rehearing in that case.

HERBERT POPE,
GEORGE I. HAIGHT,
BENJAMIN M. PRICE,
Counsel for Respondent.

WILLIAM D. MCKENZIE,
Of Counsel.

I hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay.

HERBERT POPE,
Counsel for Respondent.

pp. 3, 8.

SUPREME COURT OF THE UNITED STATES.

Nos. 49 and 48.—October Term, 1942.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, 49 *vs.* R. Douglas Stuart.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.
Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, 48 *vs.* John Stuart.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[November 16, 1942.]

Mr. Justice Reed delivered the opinion of the Court.

These petitions for certiorari bring here the liability of each respondent for increased income taxes for the years 1934 and 1935. A deficiency was determined by the Commissioner for each year because of the taxpayers' failure to include in their return income from various trusts previously created by them for the benefit of their children.

The taxpayers are brothers, residents of Illinois. In 1930 John Stuart, the respondent in No. 48, created one trust for each of his three children: Joan, Ellen and John. Later, in 1932, R. Douglas Stuart, the respondent in No. 49, created such trusts for each of his four children: Robert, Anne, Margaret and Harriet. The trusts were much alike. They were made in Illinois and specifically provided that they were to be governed by the laws of that state. The three children of John were all of age by January 1, 1934. None of the children of Douglas were of age during either of the taxable years.

By the creation of the trusts, each taxpayer transferred to three trustees certain shares of the common stock of the Quaker Oats Company, of which respondents were respectively president and first vice-president. The trustees named in each instrument were the taxpayer-settlor, his wife and his brother. The trusts created by John thus had John, his wife and Douglas as trustees and those created by Douglas had Douglas, his wife and John as trustees.

The trustees were given the power and authority of "absolute owners" over the handling of the financial details of the respective

trusts. They were freed from liability or responsibility except such as were due to actual fraud or willful mismanagement.

In the trusts created by R. Douglas Stuart for his minor children, the trustees were directed to "pay over to [the beneficiary] so much of the net income from the Trust Fund, or shall apply so much of said income for his education, support and maintenance, as to them shall seem advisable, and in such manner as to them shall seem best, and free from control of any guardian, the unexpended portion, if any, of such income to be added to the principal of the Trust Fund. When the said [beneficiary] shall attain the age of twenty-five years, the Trustees shall pay over and deliver to him one-half of the Trust Fund; and they shall pay over to him in reasonable installments the income from the remaining one-half of the Trust Fund until he shall attain the age of thirty years, when they shall pay over and deliver to him the remainder of the Trust Fund."

In the trusts created by John Stuart for his adult children the directions were that the trustees should for fifteen years "pay over and distribute, in reasonable installments," to the beneficiaries so much of the net income "as they in their sole discretion shall deem advisable, the undistributed portion of such income to be added to and become a part of the principal of the Trust Fund." After the fifteen years, the entire net income was to be paid to the beneficiary for and during her life.

Each trust provided for the devolution of the corpus to the issue of the beneficiary named in the instrument and in default of such issue to the issue of the donor and in default of issue of either, to named educational or charitable institutions.

Two paragraphs relating to changes and amendments are important. They were the same in all the instruments and read as follows:

"Eighth. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and delivering to the Trustees other property satisfactory to them of a market value at least equal to that of the property so withdrawn.

"Ninth. During the life of the Donor, the said [wife and brother of the donor], or the survivor of them, shall have full power and authority, by an instrument in writing signed and de-

livered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect."

Pursuant to the authority of paragraph ninth, the two trustees authorized in the trusts to make changes did provide on the 2d and 3d of August, 1935, respectively, for the cancellation and expunction of both the eighth and ninth paragraphs set out above and for the substitution of the following in lieu of the expunged ninth paragraph:

"Ninth. This Indenture and all of the provisions thereof are irrevocable and not subject to alteration, change or amendment."

The Commissioner does not claim that any trust income received after these amendments is attributable to the taxpayers.

In answer to the taxpayer's petition in No. 49 for the redetermination of the deficiencies, the Commissioner asserted the increase was required by the provisions of Sections 22, 166, and 167 of the Revenue Act of 1934, 48 Stat. 680. Section 22 was not raised by the Commissioner in his answer to the petition in No. 48. But the applicability of that section was raised by the Commissioner as appellee before the Circuit Court of Appeals (*Helvering* v. *Gowran*, 302 U. S. 238, 245). The contention in the Court of Appeals rested on the facts stipulated in the Board of Tax Appeals. On the rejection of that ground in the court below the Commissioner was entitled to raise the question, as he did, in his petition for certiorari and rely on Section 22 in this Court. *Helvering* v. *Gowran*, ibid, 246; cf. *Hormel* v. *Helvering*, 312 U. S. 552. So far as pertinent the sections are set out in the footnote below.*

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor.

"SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor;

then such part of the income of the trust shall be included in computing the net income of the grantor."

The Board of Tax Appeals upheld the Commissioner's determinations that Section 166 governed the trusts' incomes because the powers of the wife and brother, as trustees, under the ninth paragraph were sufficient to revest the funds in the grantors and because the trustees were without substantial adverse interests. The Circuit Court of Appeals reversed this determination, *Stuart* v. *Commissioner*, 124 F. 2d 772, on its conclusion that under the law of Illinois "the wife and brother as trustees had no authority . . . to revest the property in the grantor." The same reasoning led the appellate court to say that neither Section 167 nor 22 was applicable, except as to the income of the Douglas Stuart trusts actually used for the support of a minor child.

The applications for certiorari were granted because of differing views in the courts of appeals as to the inclusion of the incomes of trusts with similar provisions in the gross incomes of the donors by virtue of the sections of the Act relied upon by the Commissioner. *Altmaier* v. *Commissioner*, 116-F. 2d 162; *Fulham* v. *Commissioner*, 110 F. 2d 916; *Whiteley* v. *Commissioner*, 120 F. 2d 782; *Commissioner* v. *Buck*, 120 F. 2d 775.

To reach a decision as to the applicability of Sections 166 and 167 of the Revenue Act of 1934, see footnote page 3 *supra*, to these trusts, the instruments must be construed to determine whether the power to revest title to any part of the corpora in the grantors or to distribute to them any of the income lies with any persons not having a substantial adverse interest to the grantors. That construction must be made in the light of rules of law for the interpretation of such documents. The intention of Congress controls what law, federal or state, is to be applied. *Burnet* v. *Harmel*, 287 U. S. 103, 110; *Lyeth* v. *Hoey*, 305 U. S. 188, 194. Since the federal revenue laws are designed for a national scheme of taxation, their provisions are not to be deemed subject to state law "unless the language or necessary implication of the section involved" so requires. *United States* v. *Pelzer*, 312 U. S. 399, 402-3. This decision applied federal definition to determine whether an interest in property was called a "future interest." When Congress fixes a tax on the possibility of the revesting of property or the distribution of income, the "necessary implication," we think, is that the possibility is to be determined by the state law. Grantees under deeds, wills and trusts, alike, take according to the rule of the state law. The power to transfer or distribute assets of a trust

is essentially a matter of local law. *Blair* v. *Commissioner*, 300 U. S. 5, 9; *Freuler* v. *Helvering*, 291 U. S. 35, 43-45.[1] Congress has selected an event, that is the receipt or distributions of trust funds to a grantor, normally brought about by local law, and has directed a tax to be levied if that event may occur. Whether that event may or may not occur depends upon the interpretation placed upon the terms of the instrument by state law. Once rights are obtained by local law, whatever they may be called, these rights are subject to the federal definition of taxability. Recently in dealing with the estate tax levied upon the value of property passing under a general power, we said that "state law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed." *Morgan* v. *Commissioner*, 309 U. S. 78, 80 (a case dealing with the taxability at death of property passing under a general power of appointment). In this case, as in *Lyeth* v. *Hoey*,[2] we were determining what interests or rights should be taxed, not what interests or rights had been created and therefore applied the federal rule. Cf. *Burnet* v. *Harmel*, 287 U. S. 103, 110; *Palmer* v. *Bender*, 287 U. S. 551, 555; *Heiner* v. *Mellon*, 304 U. S. 271, 279; *Helvering* v. *Fuller*, 310 U. S. 69, 74. In this view the rules of law to be applied are those of Illinois. That state is the residence of the parties, the place of execution of the instrument, as well as the jurisdiction chosen by the parties to govern the instrument.

This was the view of the Circuit Court of Appeals. 124 F. 2d 772, 778. Their examination of the Illinois law led them to conclude that "the wife and brother as trustees had no authority under the Illinois law to revest the property in the grantor," a requirement for liability under Section 166. This conclusion does not spring from a statute of that state nor even from a clear or satisfying line of decisions. It is, however, the reasoned judgment of the circuit which includes Illinois in which a judge of long experience in the jurisprudence of that state participated. Without a definite conviction of error in the conclusion, this Court

[1] The incorporation of local law in federal tax acts has been repeatedly recognized. Cf. Crooks v. Harrelson, 282 U. S. 55 (Missouri real property excluded from federal estate tax because of state rule of law); Poe v. Seaborn, 282 U. S. 101 (Community property laws); Uterhart v. United States, 240 U. S. 598, 603 (Local law of wills).

[2] 305 U. S. 188, 193, 194 (Exemption from income tax of funds received by an heir in compromise of litigation over a will as an inheritance, a result contrary to the law of the state of probate).

will not reverse that judgment. *MacGregor* v. *State Mutual Life Assurance Company*, 315 U. S. 280. Cf. *Reitz* v. *Mealey*, 314 U. S. 33, p. 39; *Railroad Comm'n* v. *Pullman Co.*, 312 U. S. 496, 499.

The Government does not challenge the conclusion of the Court of Appeals that Illinois law controls. It sharply differs as to the meaning of paragraph ninth, construed generally, and as to the Illinois rule but does not urge that a federal rule of interpretation applies.

The suggestion is made that *Helvering* v. *Fitch*, 309 U. S. 149, 156; *Helvering* v. *Fuller*, 310 U. S. 69; *Helvering* v. *Leonard*, id. 80; and *Pearce* v. *Commissioner*, 315 U. S. 543, require determination by this Court of the Illinois law. In each of these cases after courts of appeals had given their opinion of the law of the respective states on the power of the state courts to alter or revise property settlements in judgments of divorce, we reviewed the state decisions to determine whether the husband or wife was taxable under the Federal tax system upon the income from the settlements. This depended upon whether the husband could show clearly and convincingly under the state law that the settlement income was not received by the wife pursuant to his continuing obligation to support or whether the wife could raise doubts and uncertainties as to the proper conclusion. *Pearce* v. *Commissioner*, *supra*, 547.

It is true we examined the state cases to determine the applicable state law but we did it for the purpose of determining whether the taxpayers had met their burden of proving the Commissioner of Internal Revenue wrong in assessing deficiencies against them. We could do the same here but we are satisfied that the finding of the Court of Appeals on Illinois law is a determination that meets that burden. A requirement of a demonstration of state law, "clearly and convincingly" may well necessitate a review of the conclusion of the Court of Appeals, while a requirement of a finding, as here, of the ultimate fact as to the law would not. If reasonably avoidable we should certainly avoid becoming a Court of first instance for the determination of the varied rules of local law prevailing in the forty-eight states. Nor do we see any reason why we should prefer the view of the Board of Tax Appeals concerning Illinois law to that of the Circuit Court of Appeals within which Illinois is embraced.

One cannot say that it would be an arbitrary or unreasonable or even an unlikely holding on the part of the courts of Illinois

to conclude that under the terms of these trusts, equity ought to and would prevent the wife and brother of the donor, claiming authority under the provisions of paragraph nine of the indenture, from vesting the property in themselves or in the donor or in others for the benefit of themselves or the donor, to the detriment of the present beneficiaries. To support this construction, the Court of Appeals cites *Frank* v. *Frank*, 305 Ill. 181, 187. In that case there was a deed for a life estate in realty with vested remainder to others with "full power and authority" to the life tenant to sell the premises by her sole deed. The life tenant sold the fee for life support, a consideration necessarily usable by the life tenant alone. The power was construed as applicable to the life estate alone and its use unauthorized for the fee. In *Rock Island Bank* v. *Rhoads*, 353 Ill. 131, 142, the Supreme Court of that state construed the authority of a life tenant to use and dispose of the property as may "in her judgment be necessary for her comfort and satisfaction in life" to stop short of permitting her to add any of the life estate property to build up her own separate estate. For the authority of courts of equity in Illinois over trustees, there are cited cases establishing their general power to require action in accordance with the intent of the donor. *Maguire* v. *City of Macomb*, 293 Ill. 441, 453; *Jones* v. *Jones*, 124 Ill. 254, 262, 264; *Welch* v. *Caldwell*, 226 Ill. 488, 495, 498.

The Commissioner cites no Illinois cases which bring us to a conviction of error on the part of the Court of Appeals. *People* v. *Kaiser*, 306 Ill. 313, goes no further than to say a residuary estate bequeathed to a trustee for gifts to such charitable institutions or needy persons as the trustee deems deserving will be enforced by the courts. It also seems that in Illinois a general power of appointment is exercisable in favor of the donee or his creditors. *Id.*, 317; *Gilman* v. *Bell*, 99 Ill. 144, 149; *Botzum* v. *Havana Ntl. Bank*, 367 Ill. 539, 543. But evidently the Court of Appeals does not consider that these trustees under Illinois law have the power to vest this property in themselves. Such a result follows from their view that the property could not be vested in the grantors. Consequently, this power of the trustees is not a general power but a power in trust exercisable as fiduciaries to carry out the purposes of the trust. We therefore do not need to decide whether if they could vest the property in themselves they would have an interest adverse to the grantor. Without that power their interest certainly is not adverse. Cf. *Reinecke* v. *Smith*, 289 U. S. 172, 174.

The real issue is whether, under Illinois law, the trustees' authority under paragraph nine of the trust instruments "to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder . . . or in any other respect," goes so far as to permit the substitution of the donor for the beneficiaries. Would the trustees with authority to change the terms and "the time when the Trust Fund . . . is to be distributed" be permitted to revoke the trust and thus vest the corpus in the donor. These questions are answered in the negative by the Court of Appeals and we accept that conclusion. These trusts, therefore, stand as though an Illinois statute or a provision of the instruments forbade assignments of any of the corpora or of the income to the grantors except as may be specifically provided by their terms. The exception is of importance in examining the trusts' provisions for the minor children of Douglas Stuart.

On the assumption that the Illinois law forbids the vesting of the trust res in the taxpayers under Section 166, it would also be impossible for the trustees to accumulate the income for or to distribute it to the grantor directly so as to come within Section 167. 124 F. 2d 772, 778. Consequently, the contention that the donors are taxable, as direct beneficiaries, because of the provisions of Section 167 alone, must fail. Could it be, however, that the donors were taxable under Section 167 because the trustees could change the beneficiaries of the trusts to the creditors of the donors or to any other person and thereby relieve the donor of a legal obligation? Assuming that such a change would result in a distribution to the grantor under Section 167 and *Douglas v. Willcuts*, 296 U. S. 1, the ruling of the Court of Appeals on Illinois law forbids such a distribution from these trusts. A decision that a donor cannot take from a trust under state law certainly prohibits a change of the instrument so as to relieve the donor of legal obligations.

The Commissioner, however, raised in the Court of Appeals and has pressed here the liability of the donors for taxation under 22 (a), see footnote page 3, on the ground that the trust incomes are chargeable to the donors under the rule of *Helvering* v. *Clifford*, 309 U. S. 331.

its income. It is obvious that if each of the trust incomes is attributable to the donors under this rule, they become a part of the present taxpayers' income under Section 167(a)(1) and (2)

also. This leads us to consider both Section 22(a) and Section 167, and their interplay on one another, together.

Section 167 took its present form in the Revenue Act of 1932. It was enacted especially to prevent avoidance of surtax by the trust device, when the income really remained in substance at the disposal of the settlor. S. Rep. No. 665, 72d Cong., 1st Sess., pp. 34-35. It is to be interpreted in the light of its purpose for the protection of the federal revenue. *United States* v. *Hodson*, 10 Wall. 395, 406; *United States* v. *Pelzer*, 312 U. S. 399, 403. Of course, where the settlor or donor is not actually or in substance a present or possible beneficiary of the trust, he escapes the surtax by a gift in trust. Revenue Act of 1934, Secs. 161 to 168, Supplement E, 48 Stat. 727. Cf. *Helvering* v. *Fuller*, 310 U. S. 69, 74. In the absence of a legislative rule, we have left to the process of repeated adjudications, the line between "gifts of income-producing property and gifts of income from property of which the donor remains the owner, for all substantial and practical purposes." *Harrison* v. *Schaffner*, 312 U. S. 579, 583.

In the John Stuart trusts the trustees, in their discretion, were to distribute income to the named beneficiaries for fifteen years and thereafter to distribute the entire net income. In the Douglas Stuart trusts, the directions authorized discretionary distribution to the beneficiaries or its application to their education, support and maintenance until the children reached the age of twenty-five years. Undistributed portions of the income were to be added to the corpus. Plainly, these distributions or accumulations were to be used for the economic advantage of the children of the settlors and to the amount of these distributions and accumulations would satisfy the normal desire of a parent to make gifts to his children. Is this alone sufficient to make the income of the trusts taxable to the settlors?

Disregarding for the moment the minority of some of the beneficiaries, we think not. So broad a basis would tax to a father the income of a simple trust with a disinterested trustee for the benefit of his adult child. No act of Congress manifests such an intention. Economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme. That gain need not be collected by the taxpayer. He may give away the right to receive it as was done in *Helvering* v. *Horst*, 311 U. S. 112, *Helvering* v. *Eubank*, 311 U. S. 122, 125, and *Harrison* v. *Schaffner*, 312 U. S. 579. But the donor nevertheless had the "use [realization] of his economic gain." 311

U. S. at 117. In none of the cases had the taxpayer really disposed of the res which produced the income. In *Corliss* v. *Bowers*, 281 U. S. 376, he had disposed of the res but with a power to revoke at any moment. This right to realize income by revocation at the settlor's option overcame the technical disposition. The "non-material satisfactions" (gifts-contributions) of a donor are not taxable as income. *Helvering* v. *Horst*, *supra*.

That economic gain for the taxable year, as distinguished from the non-material satisfactions, may be obtained through a control of a trust so complete that it must be said the taxpayer is the owner of its income. So it was in *Helvering* v. *Clifford*, 309 U. S. 331, 335, 336. Cf. *Helvering* v. *Fuller*, 310 U. S. 69, 72 note 1, 76. Section 22(a) we have said indicated the intention of Congress to use its constitutional powers of income taxation to their "full measure." *Helvering* v. *Clifford*, 309 U. S. 331, 334; *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216, 223; *Douglas* v. *Willcuts*, 296 U. S. 1, 9; *Irwin* v. *Gavit*, 268 U. S. 161, 166. Control of the stocks of the company of which the grantors were executives may have determined the manner of creating the trusts. Paragraph eight permits recapture of the stocks from the trust by payment of their value. (See page 2, *supra*). Family relationship evidently played a part in the selection of the trustees. On the other hand broad powers of management in trustees, even though without adverse interest, point to complete divestment of control, as does the impossibility of reversion to the grantors.[3] The interlocking trustees were not appointed simultaneously. The triers of fact have made no finding upon this point. Cf. *Helvering* v. *Clifford*, *supra*, 336, 338. When the Board of Tax Appeals decided these cases under Section 166 it was not necessary for it to reach a conclusion on 22(a) or its effect upon Section 167. That should be done in No. 48, the John Stuart trusts.

In No. 49, the R. Douglas Stuart trusts, the minority of each of the beneficiaries brings the income from the trusts under the provisions of 167(a)(1) and (2). The grantor owes to each the parental obligation of support. The Court of Appeals assumed that all income expended was used for such a purpose unless the taxpayer showed to the contrary. So far as the income was used

[3] Cf. Helvering v. Clifford, *supra*; Suhr v. Commissioner, 126 F. 2d 283; Whiteley v. Commissioner, 120 F. 2d 782; Commissioner v. Buck, 120 F. 2d 775; Fulham v. Commissioner, 110 F. 2d 916.

to discharge this obligation, the sums expended were properly added to the taxpayer's income.[4]

As indicated in the cases of the Board of Tax Appeals cited in the immediately preceding note, the Board has restricted the tax liability of a grantor of a trust for the support and maintenance of an infant and other purposes to such sums as, actually or by presumption, have been expended to relieve the settlor of his obligations. The Board has not taxed the whole of such income to the taxpayer merely because a part could have been but was not used for the support of an infant. We take a contrary view. Among these involved problems of statutory construction, we observe the time-tried admonition of restricting the scope of our decision to the circumstances before us. We are not here appraising the application of Section 167 to cases where a wife is the trustee or beneficiary of the funds which may be used for the family benefit. Cf. *Suhr* v. *Commissioner*, 126 F. 2d 283, 285, with *Altmaier* v. *Commissioner*, 116 F. 2d 162, and *Fulham* v. *Commissioner*, 110 F. 2d 916. We are dealing with a trust for minors where the trustees, without any interest adverse to the grantor, have authority to devote so much of the net income as "to them shall seem advisable" to the "education, support and maintenance" of the minor. The applicable statute says, "Where any part of the income . . . may . . . be distributed to the grantor . . . . then such part . . . shall be included in computing the net income of the grantor." Under such a provision the possibility of the use of the income to relieve the grantor, pro tanto, of his parental obligation is sufficient to bring the entire income of these trusts for minors within the rule of attribution laid down in *Douglas* v. *Willcuts*.

No. 48 is reversed and remanded to the Circuit Court of Appeals for remand to the Board of Tax Appeals.

No. 49 is reversed and for the reasons herein stated, the decision of the Board of Tax Appeals is affirmed.

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[4] Douglas v. Willcuts, 296 U. S. 1; Commissioner v. Grosvenor, 85 F. 2d 2; Black v. Commissioner, 36 B. T. A. 346; Tiernan v. Commissioner, 37 B. T. A. 1048, 1054; Pyeatt v. Commissioner, 39 B. T. A. 774, 780; Chandler v. Commissioner, 41 B. T. A. 165, 178; Wolcott v. Commissioner, 42 B. T. A. 1151, 1157.

See also General Counsel's Memorandum 18972, 1937-2 Cum. Bull. 231, 233.

SUPREME COURT OF THE UNITED STATES.

Nos. 49 and 48.—October Term, 1942.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,
49 vs.
R. Douglas Stuart.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,
48 vs.
John Stuart.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[November 16, 1942.]

Mr. Chief Justice Stone.

I think judgment should go for the Government in each case. Assuming, as the opinion of the Court declares, that we must look to Illinois law to determine whether the trustees were free to distribute to respondents the trust income which the Commissioner has taxed under § 167 of the Revenue Act of 1934, still I think respondents have failed to carry the burden which rests on them to show that the Illinois law prevents such distribution. The power conferred on the trustees to dispose of future income was without restriction. They were in terms authorized at any time to alter the trust instrument so as to change the beneficiary, to change the time when the trust fund or any part of it or the income was to be distributed, or to change it "in any other respect". On its face each trust gave to the trustees other than the settlor plenary power to bestow undistributed income on any person they might choose as beneficiaries, including the settlor.

We are cited to no decision in the Illinois courts which either holds or suggests that a power in trust so broadly phrased may not be exercised for the benefit of its donor. Even the generally accepted rule that the donee of a power in trust may not use it for his own benefit, which Illinois does not appear to follow, would hardly support the conclusion that he could not exercise it for the benefit of the donor. *Reinecke* v. *Smith*, 289 U. S. 172, 176. We

are without even a speculative basis in judicial authority or in reason for predicting that the Supreme Court of Illinois would forbid such an exercise of the power.

When state law has not been authoritatively declared we pay great deference to the reasoned opinion of circuit courts of appeals, whose duty it is to ascertain from all available data what the highest court of the state will probably hold the state law to be. *Wichita County* v. *City Bank*, 306 U. S. 103; *West* v. *A. T. & T. Co.*, 311 U. S. 223. But we have not wholly abdicated our function of reviewing such determinations of state law, merely because courts of appeals have made them.

Here our task is the easier because of the salutary rule that he who assails a deficiency assessment before the Board of Tax Appeals assumes the burden of showing, in point of law as well as of fact, that the tax is unlawfully assessed. *Helvering* v. *Fitch*, 309 U. S. 149. The terms of the trust instruments bring them so plainly within the provisions of the taxing statute as concededly to subject respondents to the tax unless we are able to conclude that some law of Illinois denies effect to their words. Respondents suggest no reason for such a rule of law which has ever been advanced in judicial opinion, treatise or elsewhere, and they point to no decision of the Illinois courts recognizing its existence. I am unable to conclude that it does exist and consequently that the tax was not properly laid.

The Board of Tax Appeals found that the trust instruments meant what they said and that in the family circle involved they would be carried out according to their meaning. It was hardly excessive skepticism on the Board's part to conclude that Illinois law would not prevent compliance with the expressed intention. Its judgment ought not lightly to be disregarded.

Mr. Justice BLACK and Mr. Justice DOUGLAS join in this opinion.